DOCTOR OF PHILOSOPHY

Perceptions of Earnings Management in Libyan Commercial Banks
An Accountability Perspective

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Award date:
2014

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University of Dundee

School of Business
Accounting and Finance

Perceptions of Earnings Management in Libyan Commercial Banks: An Accountability Perspective

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A Thesis Submitted to the University of Dundee in Fulfilment of the Requirements for the Degree of Doctor of Philosophy, February, 2014.

Dedication

To my father

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Acronyms

CBL	Central Bank of Libya
IAS	International Accounting Standard
ICAEW	Institute of Chartered Accountants in England and Wales
IFRS	International Financial Reporting Standard
LAAA	Libyan Accountants and Auditors Association
LCB	Libyan Commercial Bank
LSM	Libyan Stock Market
OECD	Organisation for Economic Co-operation and Development

Acknowledgements

All Praise be to God, the Lord of the worlds, prayers and peace be upon Mohammed Hi servant and Messenger, All praise be to You, we have no knowledge except what You taught us.

This thesis was made possible by the assistance and support of a number of people to whom I would like to express my special thanks. Most especially I would like to thank my supervisors Professor David Collison and Dr. Louise Crawford, who gave me the support to complete my PhD and encouraged and guided me throughout my research. I cannot tell them how much I appreciate that and cannot express my deep thanks to them enough.

I would like to express my thanks to the University of Dundee and the staff of the Accounting & Finance Division of the School of Business for their advice and the help they have given me throughout my study at Dundee.

In addition, I would also like to express my thanks to the wonderful postgraduate colleagues I have had the pleasure to study with in Dundee. My thanks also go to my friends in the Islamic, Arabic, and Saudi societies in Dundee for all their help and the great time I have had with them during my period of study in Dundee.

Thanks must also go to my family, father, mother, brothers and sisters for their support and encouragement. Last but not least, I would like to express my special thanks and my deepest feelings to my wife Hager for her patience and understanding, and without her support this work could not have been accomplished. I would also thank my daughters Farah and Noran, and my sons Mohamed and Sudad.

Declaration

I hereby declare that I am the author of this thesis; that the work of which this thesis is a record has been done by myself; and that it has not previously been accepted for a higher degree.

Signed:………………………. Date:……………….

Yaser M. B. Saleh

Certificate

We certify that Yaser M. B. Saleh has worked the equivalent of nine terms on this research, and that the conditions of the relevant ordinance and regulations have been fulfilled.

Signed:………………………. Date:……………….

Professor David Collison

Signed:………………………. Date:……………….

Dr. Louise Crawford

Abstract

This research aims to explore and identify empirically the perceptions of Libyan Commercial Banks' (LCBs) stakeholders about earnings management and its impact on the quality of financial reporting. The study examines the occurrence of earnings management and the techniques that are used to manage LCBs' earnings by first investigating the understanding of LCBs' stakeholders about the term earnings management. The study also examines perceptions of the motivations behind LCBs' managers being engaged in earnings management, as well as the perceived conditions that enable LCBs' managers to manage their earnings. Finally the study examines stakeholders' perceptions about the controls by which earnings management may be mitigated. The results of the study are interpreted through an accountability perspective. The study uses semi-structured interviews and a questionnaire survey with wide groups of stakeholders' LCBs. The findings of this study reveal a range of views regarding the quality of financial reporting between different stakeholders groups, and also within the individual groups. This finding may refer to a serious problem within the accountability relationship of the LCBs. The results findings also reveal that the term 'earnings management' is not understood consistently by different stakeholders in Libya. The findings also suggest the existence of earnings management in LCBs' financial reporting using various techniques e.g. especially the loan loss provision. The motivations of earnings management practices as revealed by the study findings are consistent with those reported in the literature. Earnings management is perceived as an unethical practice by most of the LCBs' stakeholders but there are exceptions to this view. Earnings management could be reduced, according to the perceptions of LCBs' stakeholders, by adopting IFRS, applying better corporate governance, and enhancing the role of the external auditor.

Chapter 1

Introduction

1.1 Financial Reporting Quality and Earnings Management

The accounting issue generally referred to as 'financial reporting quality' has received considerable attention in recent years. Useful information is relevant and reliable information; being reliable means information is complete, neutral, and free from error. A fundamental responsibility of management is to provide high quality financial reporting (Atik and Ismail, 2011). In other words, in order to be accountable, management has to provide quality information and act ethically, or, in the words of Cotter (2012, p. 48), to "discharge its responsibilities honestly". Financial information of quality may also be characterised as information that is useful for the decision-making process.

The quality of financial information can be assessed by, amongst other things, the incidence of earnings management (Elias, 2012). Barth et al. (2008), Chen et al. (2011), Zeghal et al. (2012) and Ahmed et al. (2013), for example, used earnings management as a proxy to test for accounting quality. Thus the link between financial reporting quality and earnings management can be clearly stated as the less earnings management, there is the higher the quality of financial reporting. The financial reporting quality issue has received repeated scrutiny in the wake of recent financial scandals and the collapse of high-profile institutions like Enron and WorldCom (Hong and Anderson, 2011). Due to these recent financial crises, as well as the audit failure in not detecting and preventing such behaviour, the accounting profession, according to Krishnan (2005), "is facing a credibility crisis" (p. 209). The collapses of well-respected companies, according to Leventis and Dimitropoulos (2012) resulted in investors losing confidence in both corporate disclosure and capital market efficiency as they have "raised many concerns about the reliability of financial reporting and the efficiency of existing monitoring mechanisms" (Leventis and Dimitropoulos, 2012, p. 161).

The recent corporate scandals have also highlighted the incidence of unethical practices conducted by business organizations (Cacioppe et al., 2008). These unethical practices that are referred to in the literature as creative accounting include earnings management, and have, according to Beaudoin et al. (2013), been the cause of the collapse of some high-profile companies and reduced confidence in financial reporting.

The issue of earnings management has continued to be problematic in the financial reporting context throughout recent decades (Heinz et al., 2013) and an important topic that concerns a wide range of stakeholders including regulators, investors and managers (Achilles et al., 2013). Its importance, according to Man and Wong (2013), stems from its negative effects on the financial statements as it “may undermine the credibility of financial statements” (p. 400). It involves deliberate management intervention in the financial reporting process to misstate reported earnings in order to achieve certain rewards (Foster and Shastri, 2013). This opportunistic managerial behaviour, according to Aerts et al. (2013) is mainly incurred for “the benefit of insiders” by consciously acting to “mislead outsiders’ perceptions” about the firm’s financial performance (p. 94). Although earnings management might arguably be used to make information more informative for outsiders given the deep knowledge that managers would have about their activities, however it is still questionable. Aerts et al. (2013) revealed that:

> “Management’s motives for earnings management are, however, not transparent from reported numbers, both manipulative [opportunistic] and communicative [informative] earnings management are likely to feed ex ante uncertainty of users with regard to earnings management consequences” (p. 94).

In addition, opportunistic earnings management, according to Habbash et al. (2013), reduces the quality of reported income as it produces less reliable reported earnings that do not reveal the true financial performance of the firm. In the words of Ascioglu et al. (2012), earnings management clearly "degrades the quality" of reported income as well as disclosure in general (p. 258).

Earnings management may have an adverse consequence on accountability relationships. Accountability or being accountable refers to the process whereby managers provide useful, unbiased, and reliable information to the firm's stakeholders. Aerts et al. (2013) outlined that earnings management could reveal an accountability breach, when they indicated:

> "Given users' ex-ante uncertainty with regard to management's earnings management motives, indications of earnings management may be perceived as a significant accountability predicament, and bring management to offer more explanations on performance-related matters…" (p. 95).

Thus, the existence of earnings management, through its adverse effect on financial reporting quality, also constitutes a serious breach of the accountability process.

The rest of this chapter is organised as follows: Section 1.2 presents the research problem and motivations. Section 1.3 discusses the study's objectives and methodology. Section 1.4 lists the main and subsidiary research questions.

1.2 Research Problem and Motivations

Regardless of the regulatory efforts that have been made to preclude earnings management, this managerial behaviour, according to Beaudoin et al. (2013), still exists and continues to concern related parties; practitioners, regulators and standard setters. Therefore, it is of great importance to understand this behaviour and highlight some means of minimizing its damaging consequences. According to Krishnan and Visvanathan (2011), "earnings management is believed to be widespread and a matter of concern to regulators and users of financial statements" (p. 133).

For Cotter (2012), the existence of such a practice is due to the fact that we live in a world that falls some way short of the perfect world. He outlines:

> "In a perfect world every business would discharge its responsibilities honestly, and there would be no suspicion of wrongdoing. In such a world it would not be necessary to monitor activities or to have penalties to punish fraudulent behaviour. There would still be a need for rules, of course, but only to ensure that business transactions were recorded consistently across firms. The world in which we live falls some way short of the one outlined above" (p. 48).

The first motivation of this study stems basically from the need to focus on the importance of accountability through high quality financial information and threats to this accountability by focusing on the issue of earnings management.

The literature provides ample evidence of earnings management in developed countries. However, very little research has been conducted for developing countries in general and for Libya in particular. The research findings from developed countries are not necessarily applicable to developing countries due to the different environmental factors which may be present. Companies operating in developing countries are unlike those of developed countries in many respects: according to Baralexis (2004), they suffer from poor management, being unlisted, and having unsophisticated users of financial information. Therefore, earnings management perceptions in developing countries might be different from those in developed countries. In addition, to the best of the researcher's knowledge, this study in focusing on listed commercial banks is the first of its kind in Libya[1]. Therefore, the current study may help in filling the gap by illustrating results from the Libyan banking sector which plays a key economic role in a specific developing country.

Financial crises have emphasized the importance of ethical behavior within the financial reporting context (Frecka, 2008) and it has been concluded that "the standard of ethical behavior is higher than a standard of just meeting the rules of financial reporting" (Frecka,

[1] The researcher is aware of only one study about earnings management by Libyan corporations conducted in 2011 and which was only available in 2013. That thesis is different from the current one in that it was undertaken to study Libyan companies that are not listed.

2008, p. 55). The accounting profession has for long been concerned about the ethics of financial reporting (Grasso et al., 2009).

Perceptions regarding the acceptability of earnings management are different. Some perceive it as ethical while others view it as unethical behavior; the overall assessment, according to Beaudoin et al. (2013), may depend on the underlying perceptions of its purpose. Prior research has stressed the importance of evaluating perceptions of earnings management to provide an overall assessment of the climate surrounding earnings management. According to Geiger and Smith (2010), “it is critically important to examine the perceptions of individuals from different countries in an attempt to evaluate the climate for earnings management that may exist…” (p. 21).

This study explores stakeholders’ views regarding the practices and ethics of earnings management within Libyan Commercial Banks (LCBs).

Financial reporting regulations have an important role to play in this area. The IASB as a regulator body, for example, affirms that the main objective of financial statements is the provision of useful financial information and it is making every effort to reduce flexibility to restrict earnings management practices (Cotter, 2012). Accounting standards, according to Zhang et al. (2013), affect the level of earnings management e.g. they will determine the degree of managerial discretion with regard to revenue and loss recognition. International Financial Reporting Standards (IFRS) have been mainly developed in order to converge accounting information globally. However, the introduction of IFRS is attracting scholars to investigate their effect on accounting quality and therefore earnings management (Zhang et al., 2013). This thesis investigates stakeholders' views in regard to the influence of IFRS on LCBs' financial reporting quality.

Corporate governance, defined as “the system by which companies are directed and controlled” (Cadbury, 1992), also has a key role to play in establishing the culture within which financial reporting takes place. Prior research indicates that good corporate governance could have an influential impact on earnings management; audit committees, for example, "can oversee internal control for financial reporting and the quality of financial information" (Man and Wong, 2013, p. 409). Good corporate governance, in general, can reduce the adverse effect of earnings management on the quality of financial reporting which helps in improving investors' confidence (Uadiale, 2012). More clearly, in the U.S. for example, good corporate governance means the "ability to mitigate listed companies earnings management activities" (Yang et al., 2012, p. 89). This study does not go in to depth in terms of corporate governance practices in Libya, it only investigates stakeholders' perceptions towards the effect that good corporate governance would have on earnings management by banks. It is worth mentioning that a corporate governance code for the commercial banks has been issued by the Central Bank of Libya and all commercial banks operating in Libya have to adhere to this Code. This Code was issued in 2006 based on OECD principles of corporate governance as well as the Basel Report on Banking Supervision for enhancing corporate governance for banking organisations with the aim to protect both shareholders and stakeholders (Zagoub, 2011).

The external auditor plays a central role in the deterrence of earnings management behaviour (Cotter, 2012). Literature shows that a high quality external audit can have an influential role in reducing earnings management practices (Frankel et al., 2002). The quality of the external audit is unobservable, however it can arguably be measured to some extent by, inter alia, auditor tenure (Piot and Janin, 2007). In the Libyan Commercial banks context, the length of an auditor-bank relationship is restricted to only two years, which may ensure that a high audit quality being conducted (of course there is a counter argument that auditors' knowledge of the business is a positive function of tenure). Moreover, only specially listed[2] auditors are allowed to perform a bank's audit, which suggests that all listed auditors are industry specialists. According to Krishnan (2003), specialist auditors are more likely to detect earnings management than non-specialists; they have the required experience and resources and are armed with an incentive (to maintain their reputation) to constrain earnings management. Ultimately the earnings quality should therefore be enhanced. The effect of auditor industry specialization on earnings management was also acknowledged recently by Sun and Liu (2013).

This research is also concerned with perceptions of external auditor effectiveness in deterring or preventing earnings management practices.

To sum up, this study examines whether earnings management is perceived to affect the financial reporting quality of LCBs by investigating the perceptions of LCBs' stakeholders regarding: the exercise of earnings management by LCBs; LCBs' motivations to practice earnings management; techniques by which earnings management may be applied in LCBs; the acceptability of earnings management as a behaviour in terms of business ethics; and factors that may have enabled LCBs to manage their earnings.

Although Cotter (2012) acknowledged that earnings management practices cannot be totally eliminated, he noted that the following approaches could potentially help in reducing this behaviour: financial regulation, the external auditor, corporate governance, ethics, whistle-blowing, and corporate social reporting. Given the thesis scope, discussion will only be restricted to the first four of these approaches. This study also examines the perceptions of LCBs' stakeholders in relation to earnings management constraints; more specifically, it addresses perceptions regarding: adopting international financial reporting standards (IFRS), applying good corporate governance, and the role of external auditors in

[2] The Central Bank of Libya requires an external auditor to prove relevant experience before being listed and, therefore, allowed for banks audit.

deterring earnings management and hence enhancing the quality of financial reporting and ultimately the accountability process in LCBs.

1.3 Research Objectives and Methodology

This research aims to explore, and identify empirically, perceptions of earnings management and related issues as practiced by LCBs from the view point of its stakeholders. First, it provides a general understanding of the stakeholders' mindfulness about the topic of earnings management, underlying motivations, and techniques, as well as how ethical it is perceived to be by different stakeholders. The research also examines stakeholders' perceptions regarding earnings management constraints; specifically, it explores views about whether the application of International Accounting Standards (IFRS) can have any role in deterring such practices. Views about the potential benefit of adopting good corporate governance practices are also investigated. Finally, this study examines stakeholders' perceptions about the role of the external auditor in respect of earnings management; in other words, perceptions are sought about to what extent the external auditor is effective in preventing such a practice.

This study adopts the interpretive paradigm. Consciously acknowledging and reflecting on a paradigm, according to Saunders et al. (2012), can help the researcher to understand and explain the social phenomena that is being examined. The interpretive paradigm is a platform from which research tries to examine ways in which the world is understood. The main concern for the researcher in this paradigm would be to discover what may potentially be "irrationalities" (Saunders et al., 2012, p. 142). The findings of this research are interpreted from an accountability perspective. This thesis adopts the normative role of accountability theory where the findings are interpreted in terms of their influence over the accountability mechanism. The objective role of accounting theory, according to Watts and Zimmerman (1978), is to "explain and predict accounting practice". However, the role of accounting theory can, and in the view of this author should, be more concerned about how accounting practice can be improved.

This study used two research methods for data collection; semi-structured interviews and a questionnaire survey.

1.4 Research Questions

To fulfil the research objectives, the main research questions this thesis tries to answer can be determined as follows:

1- To what extent is earnings management perceived to influence the quality of financial reporting in LCBs?

- ❖ *What do LCBs' stakeholders understand by the term 'earnings management'?*
- ❖ *How are LCBs' perceived as being able to manage their earnings?*
- ❖ *What are the perceived motivations behind the earnings management practices in LCBs?*
- ❖ *How do LCBs' stakeholders perceive earnings management in terms of business ethics?*
- ❖ *What factors were perceived as enabling LCBs to manage earnings?*

2- To what extent, from an accountability perspective, could such perceptions be addressed?

- ❖ *What do LCBs' stakeholders perceives the implications of adopting IFRS in relation to earnings management?*
- ❖ *How do LCBs' stakeholders perceive the role of the external auditor in relation to earnings management?*
- ❖ *How do LCBs' stakeholders perceive the implications of good corporate governance in relation to earnings management?*

As discussed above, this study aims to investigate the earnings management issues in LCBs from a stakeholders' view point. The notion behind selecting commercial banks for the study stems partially from the importance of such a sector and therefore its impact on the economy. Banks have a central function in the economy; keeping the savings of the public and financing the development of business and trade. This central role of banks justifies particular scrutiny over banks' efficiency as it would affect the growth of the economy. Moreover, given the crucial importance of the accountability system of banks, confidence in the financial reporting of banks is in the interests of a wide range of stakeholders e.g. regulators, customers, investors, and the society as a whole. The failure of banks "can result in systemic crises with adverse consequences for the economy as a whole" (Fethi and Pasiouras, 2010, p. 189). This of course has been clearly seen in many countries as a result of the recent banking crisis.

The collapse of a commercial bank would affect a wide range of stakeholders, not only shareholders. Moreover, most of the listed companies in the Libyan Stock Market (LSM) are commercial banks.

1.5 Thesis Structure

This thesis consists of eight chapters. The current chapter has provided an overview about the research topic: the study's motivations, aim and objectives as well as the potential contributions have also been outlined.

Chapter 2 provides the background of Libya; it tries to put the research into the Libyan context by studying the local environmental factors that may have influenced and continue to influence the accounting practices in Libya.

The literature on the earnings management phenomenon is reviewed in Chapter 3. This provides various definitions for earnings management and discusses the underlying motivations that induce such a practice. The ethics of earnings management is also discussed in this chapter as well as earnings management practices in the banking sector.

Chapter 4 reviews the accountability theory literature. The accountability concept is discussed and two notions of accountability are outlined.

Chapter 5 outlines the methodology adopted in this thesis and highlights the research methods used.

Chapters 6 and 7 report the findings of the two pieces of empirical work that were employed to collect the data for this thesis, semi-structured interviews and a questionnaire survey respectively.

Chapter 8 summarises and reports the major findings. It also outlines the main contributions of the study and the study limitations, and finally it suggests some future research.

Chapter 2

The Libyan Context

2.1 Introduction

This chapter outlines the Libyan context by examining the national environment in which Libyan accounting practice has developed. This study is concerned with the topic of earnings management and its related issues within LCBs from an accountability perspective. Studying the environmental factors in Libya will provide a good understanding of the current accounting practices and reporting process in this country. It has been argued that accounting differs from one country to another and this is mainly due to different environmental factors that exist in each country. In this context, Adhikari and Tondkar (1992) suggest:

> "It is generally agreed that accounting diversity exists because accounting reporting and disclosure standards and practices do not develop in a vacuum but reflect the particular environment in which they are developed. Given that environments differ from country to country, accounting reporting and disclosure standards and practices would necessarily be expected to exhibit diversity" (p. 76).

Accounting literature suggests that accounting research cannot be conducted without considering the context in which accounting is practiced. Libya, as a developing country, has its own history, politics, culture and regulatory regimes which have to be considered when conducting any accounting research. Wallace (1990) has claimed that the environment will have a strong impact on financial reporting in any developing country. He indicated:

> "Developing countries are not a homogeneous group. Each country is different in terms of GNP [Gross National Product], population, culture, degree of literacy, economic and political systems- factors which invariably have an impact on the nature and extent of financial reporting" (p. 3).

This Chapter is divided into five sections. The next section provides a brief review of the Libyan background. Then the national environmental factors that are believed to have an impact on accounting practices in Libya are briefly discussed; the economic system, the political system, the legal system, the education system and religion. Section 2.4 attempts to describe the current status of the accounting profession in Libya. Section 2.5 summarises this Chapter.

2.2 Background of Libya

Libya is a developing country located in North Africa with a Mediterranean coastline of about 1,770 km that makes it the longest in North Africa. The nation shares borders with Egypt to the east; Tunis and Algeria to the west; Niger and Chad to the south. The country occupies a relatively a large area of landmass, about 1.76 million square kilometres, which makes it the fourth-largest country in Africa and almost half the size of Europe (Oxford Business Group, 2008; Pratten and Mashat, 2009). The majority of this area (about 90%) is desert or semi-desert (CIA, 2012).

Economically Libya possesses a significant position globally being a major oil producer. According to Mashat (2005), Libya is:

> "… a developing country which has experienced dynamic changes over a short period of time. Its position as the second largest oil producer in Africa, one of Europe's biggest North African oil suppliers and an active member of the Organization of Petroleum Exporting Countries OPEC since 1962 that produces high-quality, low-sulphur, crude oil at very low cost might mean that this country possesses a significant world economic standing" (p. 11).

Moreover, Libya holds oil reserves amounting to 47.1 billion barrels (as of Jan 2012), these reserves are the largest in Africa and make Libya one of the big ten in the world. In addition to oil reserves, natural gas reserves are estimated to reach 52.8 trillion cubic feet (as of Jan 2012), ranking the country as the fourth gas producer in Africa (EIA, 2012).

Figure 2.1: Libya Map

The country's official language is Arabic with English and Italian being understood in the major cities (FCO, 2012). Libyan culture is characterized by, in addition to its Arabic language, the Islamic religion. Unlike many other Arab countries that have more than one religion, the majority of Libya (97%) are Sunni Muslim of the Malikite rite (Mashat, 2005). Another aspect of Libya's culture is its focus on both privacy and family values (Oxford Business Group, 2008). Population as revealed in the 2006 census was 5,298,152. However, the estimated Libyan population in July 2012 is approximately 5.6 m people (CIA, 2012). The population density for the country is three people per square kilometre which puts the country as amongst the least densely populated in the world. However, the majority of the population (90%) lives around the coastline and this area represents only 10% of the country's total. A third of the entire population lives in the two major cities; Tripoli and Benghazi (Business Oxford Group, 2008).

2.3 The Environmental Factors in Libya

A number of environmental factors[3] which have been identified in the literature are suggested to have an influence over the accounting profession. For the purpose of this chapter, a number of environmental factors which are deemed most relevant for this chapter will be examined. This chapter draws on Iqbal's (2002) classification of environmental factors that affect accounting practices and financial reporting in a particular country: (1) the economic system; (2) the political system; (3) the legal system; (4) the educational system and; (5) the religion. These factors, collectively, form the cultural values of a country which consequently affect, inter alia, the accounting practices and financial reporting procedures. In the following sections, brief discussions on how such factors may have an influence on the accounting system in Libya are provided.

2.3.1 The Political System

The accounting literature documents that political factors, among others, have an influence on accounting practices (Alhashim and Arpan, 1988). This section provides a brief historical background on the changes to the political system of Libya over the past six decades.

Due to its location in the mid-Mediterranean part of North Africa, as a connection point between Europe and Central Africa, and between the Middle East and North West Africa, the country, for almost 3,000 years, has been a target for many military invasions and colonisations until it declared independence on 24th of December 1951[4] under the leadership of King Idris Al-Sanussi (Mahmud, 1997). During a period of 3,000 years of invasions, Libya was attacked by different nations, including the Phoenicians, the

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[3] This chapter is restricted to examine the internal environmental factors. External factors as described by Doupnik and Salter (1995) are beyond the scope of this discussion. External factors, according to Doupnik and Salter (1995), "encompasses diverse influences" for example, the economic conditions, geography, colonization, climate, technology, disease, and relationships with other countries. (p. 194).

[4] On 21 November 1949, the UN General Assembly passed a resolution stating that Libya should become independent before 1st January 1952… When Libya declared its independence on December 24, 1951, it was the first country to do so through the United Nations (FCO, 2012).

Carthaginians, the Greeks, the Romans, Spaniards, Vandals, and the Byzantine Empire. Libya has also been occupied by Muslim Arabs, Ottoman Turks and a more recent military invasion by Italy in 1911 (Mahmud, 1997; Kribat, 2009). Table 2.3 shows the main historical events in Libya.

Table 2.1 Main Historical Events of Libya

Date	Event
Before 642	Libya was occupied by the Phoenicians, Carthaginians, Greeks, Romans, Vandals and Byzantines.
642-1510	Arab Islamic Rule: Libya conquered by Arab Islamic conquerors. In this period, Libya was ruled by several Islamic rulers (states).
1510-1551	Tripoli was invaded by the Hapsburg Spain.
1551-1911	Ottoman Empire: Libya was occupied by Ottoman Turks and it remained part of the Ottoman Empire.
1911-1943	Italian Colony: the Italians supplanted the Ottoman Turks in the area around Tripoli in 1911 and did not relinquish their hold until 1943 when defeated in World War II.
1943-1951	British and French military administration: the Allied powers controlled Libya and then it passed to UN administration and achieved independence in 1951.
1951-1969	Independence and the United Kingdom of Libya: Libyan gained its independence on 24th of December 1951, as a constitutional and hereditary monarchy under the King Idris Al-Sanuusi.
1959	The discovery of significant oil reserves: enabling one of the world's poorest nations to establish an extremely wealthy state, and become one of world's leading oil producers.
1969-1973	September military coup in 1969 (Libyan Arab Republic): the governing authority became the Revolution Command Council (RCC) led by Gaddafi.
1973-1977	In 1973, Gaddafi declared the Cultural Revolution to encourage people to participate in political life by creation of the "People's Committees" to administer local and regional administrations. This caused administrative chaos in the country by abolishing all laws; eliminating political parties which were intended as revolution's enemies.
1977-2011	"The People's Authority" the RCC was replaced by the General People's Congress (GPC) as a parliamentary body (the highest legislative authority) which established the new political regime for the country, 'The People's Authority'.
Feb 2011	Anti-Gaddafi Uprising: on 15th February a violent protest in Benghazi (in the east of Libya) was sparked in response to a human rights campaigner arrest. Uprising then becomes a people' revolution and spread almost to all Libyan cities.
Mar 2011	National Transitional Council (NTC) was formed in Benghazi to represent the rebels locally and internationally. The main objective for NTC was to get rid of the Gaddafi regime and guide the country toward democracy.
Aug 2011	Country's Capitol Liberty: in 20th Aug, rebels entered Tripoli from three axes, three days later the capital was declared liberated.
Oct 2011	Death of the Tyrant: on 20th of Oct, rebels captured and killed Gaddafi in his birth town of Sirte.
Aug 2012- Now	General National Congress (GNC): NTC passed the power to GNC. GNC has elected Dr. Mohammed Magarief as its chairman, therefore, becoming the interim head of state.

Adaptation from: Zagoub (2011, p. 13); BBC (2012a).

From 1969 until February 2011, Libya was governed by the Gaddafi regime. In early 2011 violent protests erupted in Benghazi and these were promptly followed in other cities which quickly led to a public revolution which overthrew the Gaddafi regime[5]. Gaddafi had ruled the country since 1969 when he took power in a bloodless coup that overthrew King Idris; subsequently he ruled as a dictator. Since that time he ruled the country "with an iron fist" until the country "embarked on a radically new chapter in its history" following the revolution (BBC, 2012a, 2012b). Gaddafi's life was full of controversy. At the beginning, Gaddafi was influenced by, and emulated, the Egyptian leader Jamal Abdel Nasser. However, he then ruled the country in ways which were "increasingly eccentric". In 1975, he published his Green Book in which he put his ideas forth (the Third International Theory) as an alternative to both communism and capitalism. As a consequence of his book, Libya became known as 'Jamahirya' which loosely can be translated into the 'state of masses'. According to the Green Book, Libya was governed by a direct democratic system by which peoples' committees took power to rule the country. However, in fact the real power was only with Gaddafi (BBC, 2012a). The year 2011 has seen unprecedented developments in Libyan modern history. After 42 years of tyranny and repression, Libya embarked on a revolution to end decades of repression. Rebels then organised a leadership called the National Transitional Council (NTC) to organise the rebels' efforts and represent them locally and later internationally (The World Bank, 2012). The NTC met for the first time in 5th March 2011 in Benghazi, where it based, to declare itself the sole representative of Libya acting on behalf of the rebellion against the Gaddafi regime. The NTC has made it clear that it is only a transitional government and not an interim government; later on 15th July 2011 the NTC was recognised as the only legitimate representative authority in Libya by the 'Libya Contact Group[6]' (FCO, 2012).

[5] "Libya's long-time leader Col Muammar Gaddafi was killed [on 20th October, 2011] in his home town of Sirte, officials say, by forces who have been trying to topple him since February, with the backing of Western and Arab nations " (BBC, 2012).

[6] This groups was established mainly to support the NTC' efforts in the London Conference on Libya that was held in 29th March, 2011, by foreign ministers and organisations from over 40 countries (FCO, 2012).

2.3.2 The Economic System

Prior research suggests that accounting developments in a specific country are basically influenced, among other things, by their economic environment (HassanElnaby et al., 2003). Prior research also suggests that accounting development, to a large extent, depends on the economic stability of the country (Iqbal, 2002). This section sheds light on the Libyan economic environment both prior to and after the discovery of oil.

Prior to the discovery of oil in Libya, Libya was considered as one of the poorest countries around the world with no natural resources, no skilled labour, severe weather conditions, and with no potential economic prospects. It was also described as a "hopeless case" (Higgins, 1968, p. 819). The economic condition at that time (prior to the oil discovery) can be seen through Higgins[7] (1968) description of the Libyan economic situation as follows:

> "Its [Libya] great merit as a case study is as a prototype of a poor country. We need not construct abstract models of an economy where the bulk of the people live on a subsistence level, where per capita income is well below $50 per year, where there are no sources of power and no mineral resources, where agricultural expansion is severely limited by climatic conditions, where capital formation is zero or less, where there is no skilled labor supply and no indigenous entrepreneurship. When Libya became an independent kingdom under United Nations auspices … it fulfilled all these conditions. Libya is at the bottom of the range in income and resources and so provides a reference point for comparison with all other countries" (p. 819).

This situation remained until the discovery of oil in commercial quantities in 1959[8]. The country then became one of the principal oil producers in the world which transformed the country from a poor to a wealthy nation (Zagoub, 2011). The petroleum sector then became the core sector in the Libyan economic system; it has become the main source of finance and significant economic growth took place[9] for the first time. According to Chami et al (2012), oil revenues amount to about 90% of total revenues for the government. Table

[7] Higgins worked as an economic advisor to Libya in the early 1950s (Mahmud, 1997).
[8] The export of crude oil started in 1961 (Zagoub, 2011).
[9] Before oil discovery, Libyan economy was suffering from deficits and the main sources for public expenditures were domestic revenues and foreign aid (Mahmud, 1997).

2.1 illustrates the total revenues divided into oil and non-oil revenues for the years of 2008, 2009, and 2010.

Table 2.2: Libyan Total Revenues (LD[10] million)

Items	2008	2009	2010
Oil revenues	64,417.0	35,347.0	55,713.0
Non-oil revenues	8,324.2	64,38.0	5,790.1
Total revenues	**72,741.2**	**41,785.0**	**61,503.1**
Oil and natural gas %	88.5%	84.5%	90.5%

Adaptation from: the Central Bank of Libya (2012).

The rapid growth of the Libyan economy influenced by the oil discovery has been described by El-Mallakh (1969, cited in Mahumd, 1997) as follows:

> "If the economic growth occurring today in Libya were described without identifying the country, it would be dismissed most likely as an extremely hypothetical case, too dramatic to be real" (p. 308).

Being the main source of the country's finance, the oil sales have played an important role in the country's development and infrastructure. This makes the petroleum sector the prime sector in the Libyan economy. Oil revenues have been responsible for enabling the country to develop its infrastructure system (Zagoub, 2011). In its report on Libya, the Oxford Business Group (2008) commented on the Libyan natural resources as follows:

> "Hydrocarbons are by far the most important natural resources at the country's disposal. Libya's total proven oil reserves amount to approximately 44bn barrels of crude oil. Currently 12 oil fields are in the process of being explored and around 25% of the country is covered by exploration agreements with oil companies, suggesting that the potential for the country's energy industry is enormous" (p. 14).

Hydrocarbon revenues amount to about 70% of the country's Gross Domestic Product (GDP) and more than 95% of its exports (Chami et al., 2012). Table 2.2 shows the oil and non-oil revenues compared to the country's GDP for 2008, 2009, and 2010.

Table 2.3: Libya GDP (LD million)

Economic Sector	2008	2009	2010
Oil and natural gas extraction	81,149.8	47,087.1	60,814.5
Other economic activities	35,489.8	39,201.9	41,723.8
Total GDP	**116,639.6**	**86,289.0**	**102,538.2**
Oil and natural gas %	69.5%	54.5%	59%

Adaptation from: the Central Bank of Libya (2012).

[10] The conversion rate of Libyan Dinar to Pounds Sterling was approximately 2.06 as at 31/12/2013.

Libya has a significant position in the world's energy market holding about 3.5% of the world's proven crude oil reserves (Chami et al., 2012). Before the revolution of 17th Feb[11], the Libyan economy was characterised by remarkable levels of growth. After that date, because of the revolution and the freezing of the country's foreign assets by the UN the country's economy was adversely effected. The African Economic Outlook (2012) has commented:

> "Libya's economy, previously known for impressive levels of growth driven by its oil and gas industry, was seriously disrupted by the 2011 civil war. In addition to the impact that the freezing of the country's assets had on liquidity, the economy was disrupted by the shutdown in oil production and exports, as well as the decline of productivity resulting from the loss of human capital and the destruction of infrastructure" (p. 4).

Oil production dropped to its lowest level of 22,000 barrels per day[12] due to the crisis which is a big hit for the economy bearing in mind that the production level before the crisis was 1.77 million barrels per day. However, the economy began to recover in early 2012 when the crude oil production again exceeded 1 million barrels per day and it is expected to reach the pre-crisis level by 2014 (Chami et al., 2012). Figure 2.2 illustrates the crude oil production of the Libyan State during the period January 2000 until May 2012.

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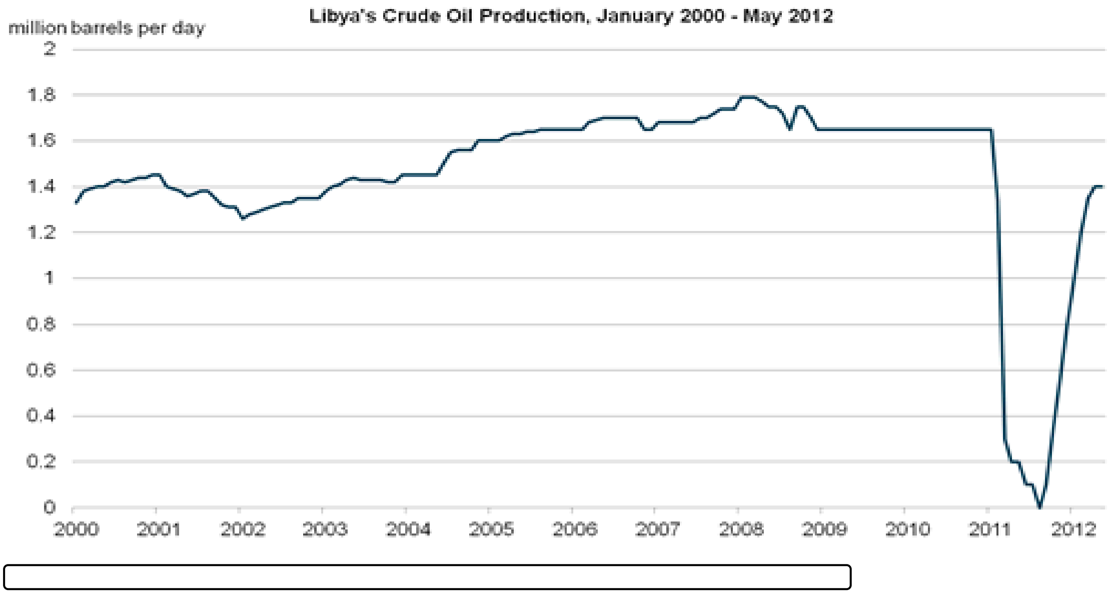
[11] On 15th Feb 2011 a public revolution to overthrow the regime had started to declare the country's liberty on 23th Oct 2011 (BBC, 2012). It was planned to start revolution on 17th Feb, the date when a demonstration started in Benghazi in 2006 against the Italian ministry who appeared on TV showing the photo of who made the film that abusing our Prophet Mohamed, but the Libyan police by time arrested a human rights campaigner who used to guide demonstrations against the regime in Benghazi which provoked people against the regime and start the Revolution (BBC, 2012a).

[12] The official production quota, according to OPEC, is 1.47 m barrels per day (AfDB et al., 2012).

Figure 2.2: The Oil Production Stream in Libya for the Period 2000-2012



Source: U.S Energy Information Administration.

The modern development of Libya has been significantly influenced by the discovery of oil, the September military coup (Zagoub, 2011) and of course by the revolution of 17th Feb 2011. There is widespread agreement that an economic system of a country is, to large extent, influenced by its political system. Roberts et al. (2008) conclude that:

> "Differences in political systems will be reflected in differences in how the economy is organised and controlled. This will in turn influence the objectives or role of accounting" (p. 202).

2.3.3 The Legal System

Countries differ in terms of their legal systems. There is a great deal of agreement that two principal types of legal systems are identified in the literature: namely, code law and common law (Doupnik and Perera, 2007). Laws in code law countries, according to Roberts et al. (2008), tend to regulate and mandate acceptable behaviour; they consist of rules and procedures that have to be applied by all commercial organisations including those relating to accounting. Accounting in code law countries is thus regulated by governments in order to control and ensure "orderly business conduct". They add that in such countries, the tax authority represents an often important user of accounting information; thus, accounting regulations are often set to ensure the need of tax authorities given the fact that they are important users., Also most business organisations are not listed and thereby do not have many external shareholders (Roberts et al., 2008). Accounting regulations, in code law countries, are basically characterised as being "prescriptive, detailed and procedural" as they set forth in detail the disclosure requirements and book-keeping rules and measurements that are to be employed (Roberts et al., 2008).

In common law countries, laws tend to prevent unacceptable practices and behaviours rather than prescribing acceptable behaviour. This system originated in the UK and was exported later to the USA and Commonwealth countries in different forms. A considerable amount of the law is developed by judges and is court determined based on certain disputes; this makes common law less detailed than code law. However, common law is characterised as being more flexible than code law. In the UK, as a good example of a common law country, accounting is regulated by Companies Acts which are concerned with the protection of shareholders. They impose certain provisions to produce financial statements that represent a 'true and fair' view of the financial position. This view has been interpreted by courts by following and adopting accounting standards set by the Accounting Standards Board (ASB) a private professional body that is concerned with issuing accounting standards in the UK[13]. Unlike code law countries, the main user of financial information in common law countries is finance providers (Roberts et al., 2008).

The legal system, generally, is enshrined in a country's legislation. The following sub-section examines the Libyan legislation that may have an impact on accounting practice and the financial reporting of the banking sector in Libya. This legislation can be summarised as follows; commercial law, income tax law, stock market law and banking law.

[13] IFRS have been considered instead of ASB from 2005 in judging listed companies; however common law principles still apply and informe judgments (Roberts et al., 2008).

2.3.3.1 The Commercial Law

In January 2010 the Libyan government issued a new commercial law, No. 23 to regulate all economic activities[14]. This law organises all commercial transactions that are carried on by all business parties including some requirements that interact with accounting and reporting issues for companies including commercial banks. For example, Article 18 requires that every company regulated by this law appoints a licensed auditor to undertake its accounts audit while Article 209 states that an auditor has to issue an audit report embodying his opinion on a company's accounting affairs; this report has to assert that the company's accounts are correct and comply with the law. The auditor's report also has to state that accounts have been prepared according to the approved accounting standards[15]. According to the law, the board of directors of the company have to prepare the financial statements of the company along with notes to them. The board is also required to submit a report highlighting the company's activity during the period (Article 226). Article 227 stipulates the items to be included within the balance sheet stating that company's assets and liabilities have to be recorded and disclosed in separate disclosures with no set off between accounts. According to Article 227 the assets side should include the following accounts;

1- Amounts due from shareholders.
2- Properties.
3- Plant and equipment.
4- Patents.
5- Trademarks and goodwill.
6- Fixed assets.
7- Raw material.
8- Cash and cash equivalent.
9- Bonds.
10- Associates.
11- Receivables and due from others.

On the other hand, the following items should be disclosed in the liability side;

[14] The Libyan commercial law was first issued in 1953 to be revised many times until this latest update.
[15] The Commercial Law has not defined what approved accounting standards are.

1- Capital and ordinary shares.
2- Legal reserves[16].
3- Any provision required by company's contract.
4- Accumulated depreciation and impairment allowance.
5- Compensation provision.
6- Trade payables and other payables.
7- Creditors.

The Law has identified the valuation basis to account for balance sheet items; according to Article 228, property, plants and equipment should be accounted for using historical cost and be depreciated each accounting period. Raw material and goods shouldn't be recognised at over cost or market value which means to be recorded at the lower of cost or market value. Patents, copy right and trademarks also should be recognised by cost at purchase and be depreciated over their lifecycle. Investments in equity value is left to the board of directors to determine but they should pay special attention to those shares which are traded in the stock market when it comes to valuation at the end of the accounting period; the adopted valuation basis should be shared with the control committee[17] of the company. Loans and receivables should be recognised based on the expected amount to be received. If a company's capital has declined by over one third as a result of a loss, the law requires that the board of directors will call an extraordinary meeting to discuss the issue. If the company has incurred a loss during the next period, which means that the total loss is over one third of the capital, capital has to be decreased by the loss amount otherwise shareholders will have to capitalise the company (Article 152).

[16] Article 231 of the law requires that 5% of profits to be deducted as a legal provision until it reaches 25% of the capital. This provision is called 'legal provision'.
[17] According to the law, each company has to appoint a control (watchdog) committee to monitor the company's management to ensure that all activities have been according to rules and regulations as well as maintain the accounting books that required by law. The committee also responsible for ensuring the accuracy of both balance sheet and profit and loss account. It is required that a control committee should include a member of accounting background as well as a legal member. It should consist of three principal members and two alternatives (Articles 196 and 200).

2.3.3.2 The Income Tax Law

The taxation system has an influence on the financial reporting and accounting practices either directly or indirectly. Libya's legal system was influenced by the Italian colonization that took place from 1911 until 1945, as the Italian income tax law was applied from 1923 till 1968 when the first Libyan income tax legislation was issued (Mahmud, 1997; Mashat, 2005). Currently, income tax in Libya is regulated by the Law No. 7 that was enacted in 2010. This states in its first Article that all income that occurs within Libya as a result of assets either physical or intangible is subject to taxation according to this law. According to Article 71 of the Law, any company that is operating in Libya has to submit its financial statements within four months after its financial year-end and also every company's financial statements have to be signed by an external auditor who is a member of the Libyan Accountants and Auditors Association (LAAA). Accounting practices in Libya have been, to large extent, influenced by the income tax law (Mahmud, 1997). Kribat (2009) indicates that lack of external users of financial statements may have been significant for the role in tax law, it having a great impact on financial reporting in Libya. He states:

> "Given the statutory power of Libyan tax officers to require that financial statements are prepared in accordance to the Tax Law –and because of the generally low demand for financial statements from other parties- many Libyan companies adopted the income Tax Law requirements and guidelines as the basis of internal and external financial reporting practices" (p. 27).

Some areas in the tax law which influenced accounting practices can be identified; fixed assets, for example, are recognised at historical cost and depreciated using the straight-line method with specified rates for different types of asset being given (Article 35 of the regulation of the law)[18]. Another example is setting-up costs which are allowed to be depreciated over five years using again the straight-line method. The tax law allows for goodwill depreciation over twenty years using the straight-line method; goodwill must be

[18] It is the regulation that explains how income tax law should be implemented.

purchased. Article 38 of the law states that donations of up to 2% of net income are allowed only if paid to charities recognised by the state. Losses can be carried forward for up to five years.

2.3.3.3 Stock Market Law

The Libyan Stock Market (LSM) was first established in 2006 by Law No. 134. It has been re-organised again by Law No. 11 which was enacted in 2010. The LSM requires listed companies to prepare their financial statements according to International Accounting Standards and requires that these statements have to be audited in accordance with International Auditing Standards (Kribat, 2009). The LSM also requires listed companies to submit to the LSM quarterly, semi-annual and annual reports and to publish a summary of the financial position of the company in two local newspapers, one of which, in Arabic, must appear within one week of being approved by a general meeting (Article 23). Although companies are encouraged to list on the LSM, only 13 companies are listed and traded in the LSM[19] at the time of writing including seven commercial banks. Article 75 grants listed companies that have at least 60 days of share trading during the year the following advantages: (i) tax relief from income tax for five years; afterwards 50% relief as long as company is still listed; and (ii) 50% relief on custom and stamp duties.

2.3.3.4 Commercial Banks Law

The current banking Law No. 1 was issued in 2005 to organise the business of the banking sector in Libya comprising the Central Bank of Libya (CBL), the commercial banks, and specialised banks. The CBL’s duties and responsibilities are articulated by Article 5 of the law. It is responsible, for example, for issuing the Libyan currency, managing the State’s reserves of gold and foreign exchange, regulating the monetary policy of the country, and regulating and supervising the credit and banking policy. Articles 24, 25, and 26 of the law deal with how the CBL’s financial statements should be prepared and audited. According

[19] Listed companies can be viewed at http://www.lsm.ly.

to Article 24, the CBL has to prepare and publish a statement of its assets and liabilities on a daily basis. This statement is to be sent to the government and published in the Register of Procedures. Article 25 requires that the CBL's accounts are prepared and audited according to the International Accounting Standards (IAS/IFRS) and International Standards on Auditing (ISA).

The CBL, according to Article 71, is responsible for monitoring and controlling all commercial banks that operate within the country. Moreover, interrelationships between commercial banks are also monitored by the CBL. A commercial bank, according to article No. 65 of the law, is defined as follows:

> "Any company that ordinarily accepts deposits in current demand account or time deposits, grants loans and credit facilities, and engages in other such banking activities according to the provisions of paragraph (II) of this article shall be considered a commercial bank".

Commercial banks' activities are also determined by the law. Paragraph (II) of Article 65 lists the activities that a commercial bank is allowed to carry out as follows:

1. The cashing of cheques made out to and by customers.
2. Services relating to documentary credits, documents for collection, and letters of credit.
3. Issuance and management of instruments of payment including monetary drawings, financial transfers, payment and credit cards, traveller's checks, etc.
4. Sale and purchase transactions involving monetary market instruments and capital market instrument to the credit of the bank or its customers.
5. The purchase and sale of debt, with or without the right of recourse.
6. Lease financing operations.
7. Foreign exchange transactions in spot and forward exchange markets.
8. The management, coverage, distribution, and transition of banknote issues.
9. The provision of investment and other services for investment portfolios, and the provision of investment trustee services, including the management and investment of funds for a third party.
10. Management and safekeeping of securities and valuables.
11. Provision of trustee or financial investor services.
12. Any other banking activities approved by the Central Bank of Libya.

The law also has some articles that affect the accounting practices and financial reporting of the commercial banks. In its Article 73, for example, a commercial bank must retain a capital reserve in which no less than 25% of net profit has to be transferred to this reserve until it reaches 50% of the capital; afterwards 10% of the net profit is transferred each year to the reserve. Every commercial bank has to appoint two external auditors for its financial year audit. These two auditors have to be registered[20] with the Central Bank of Libya; the external auditor's duties are determined by paragraph (II) of Article 83 as follows:

> "(i) prepare a report on the bank's annual financial statements. The report should include the methods used to ascertain the existence of and to valuate assets, the method for appraising existing commitments, and the extent to which the audited transactions comply with the law; (ii) prepare a semi-annual report monitoring the banks' financial and administrative performance and compliance with domestic and international banking criteria; and (iii) send a copy of the two reports mentioned in the previous two subparagraphs to the Central Bank of Libya within the period set by the governor".

It is worth noting that Libyan Commercial Banks vary in terms of ownership that range from State owned to completely privately owned. Table 2.4 presents the ownership structure of the Libyan Commercial Banks.

Table 2.4: The Libyan Commercial Banks Ownership Structure

Bank name	Listed	Ownership structure					Total Assets (bi LYD)	Total Deposits (bi LYD)	Market Share (%)
		State-owned	Mixed ownership			Private banks			
			State-owned	Domestic investors	Foreign investors				
Al-Gumhouria Bank	L	100%					24.65	19.61	40.31
National Commercial Bank	L	100%					11.11	9.06	18.17
Sahara Bank	L		55%	26%	19%		10.15	8.12	16.59
Al-Wahda Bank	L		54%	27%	19%		8.39	7.24	13.72
Commerce & Development Bank	L					100%	2.27	1.97	3.71
North Africa Bank		100%					1.78	1.01	2.91
Al-Amman Bank			n/a	60%	40%		0.72	0.56	1.18
Al-Waha Bank			45%		55%		0.60	0.43	0.98
First Gulf Libyan Bank			50%		50%		0.42	0.15	0.68
Alejmaa Alarabi Bank						100%	0.29	0.20	0.48
United Bank				60%	40%		0.29	0.18	0.48
Al-Wafa Bank			20%	80%			0.18	0.13	0.30
Mediterranean Bank	L					100%	0.12	0.08	0.20
Arabic Commercial Bank						100%	0.09	0.07	0.15
Alsaraya Bank	L					100%	0.09	0.06	0.14
The Libyan Qatari Bank			50%		50%		n/a	n/a	n/a
	Total						**61.16**	**48.85**	**100**

Adaptation from: Zagoub (2011, p. 30).

2.3.4 The Educational System

Literature suggests an influential role for the education system on accounting of a country. According to Iqbal (2002), both the education system and literacy levels in a country have

[20] Article 82 of the law requires the Central Bank of Libya to maintain a register of external auditors who are capable of auditing and inspecting banks' accounts.

an impact on the accounting system of that country. He indicates that users of a good education system in a country can easily understand accounting information. On the other hand, the accountants of that country would also be skilled and trained. The accounting education system in a country is important as it represents the first stage on a student's journey to becoming a professional accountant (Ahmed and Gao, 2004). The importance of an accounting education system being designed to meet national needs has been emphasised by Mahmud (1997).

The formal accounting education system in Libya can be divided into two main levels: pre-university level and university level. The pre-university level started in 1953 when the School of Public Administration was founded. The main objective of the School was to develop graduate clerks and book-keepers (Ahmed and Gao, 2004). The university level began in 1957 when the Accounting Department in the Faculty of Economics and Commerce at the University of Libya (currently the University of Benghazi) was founded[21] (Ahmed and Gao, 2004). During the period 1957-1976 the Libyan accounting education system was "British orientated" until 1976 when the system was converted to become "American oriented"[22](Mahmud and Russell, 2003). The accounting education system has been influenced by a number of factors; these factors are summarised by Mahmud and Russell (2003) as follows:

> "(a) the structure and the content of the accounting courses of the College of Economics and Commerce; and (b) the education and background of its accounting academics which are mainly American or British oriented" (p. 200).

A major problem that the Libyan accounting system may have, according to Ahmed and Gao (2004), is the lack of PhD programmes in Libya since most of the academic staff that

[21] According to Mahmud and Russell (2003), it was the first time an accounting education program had been introduced. Since the School of Public Administration was founded before that time, they appear to have been referring to the university level programmes.
[22] For the difference between the two systems, see (Mahmud, 1997). For more information about the models and syllabus taught in the University of Benghazi (Garyounis), as an example of a Libyan one, please refer to Ahmed and Gao (2003, p.378).

hold PhDs are from either the UK or US. This is again an influence on the accounting education system as well as on the accounting profession; it has adopted a Western accounting focus that lacks some links to the Libyan environment as a Muslim country (Ahemd and Gao, 2004). The study by Mahumd and Russell (2003) revealed a number of factors that obstructed accounting education development in Libya but foremost the system was limited by two main factors; the "lack of active professional societies" and an "inadequate public understanding of the role of accounting" (p. 230). Although they were silent regarding who was to blame for these two factors, one could infer that both the accounting education system and the accounting profession represented by the LAAA may have been responsible largely for such a conclusion.

2.3.5 Religion

This factor is considered to be significant in Muslim countries. Iqbal (2002) suggests:

> "The degree of influence of religion, as an environmental factor, varies from country to country. In many parts of the world, especially in some Muslim countries, it is perhaps the most powerful of the environmental influences" (p. 120).

As discussed earlier, the Libyan accounting system, as well as the accounting profession, has been greatly impacted by Western accounting. However, in a Muslim country, like Libya, the philosophy and institutional framework that govern accounting and financial reporting are different from those applied in the West (Ahmed and Gao, 2004). One of the fundamental differences between the two is how the concept of accountability is perceived (Maali et al., 2006). In the West, the companies are only responsible and therefore accountable to their stakeholders and in particular to shareholders while in the Islamic world, firms as well as individuals are held accountable beyond that limit, to God. Therefore, each Muslim is explicitly held responsible and accountable to God for everything he/she did including commercial activities (Lewis, 2001; Maali et al., 2006). As a consequence, accounting and financial reporting in a Muslim country should consider

Islamic principles when accountability is discharged, given the fact that Islam is regulating every facet in a Muslim's life. In Lewis (2001) words:

> "Just as Islam regulates and influences all other spheres of life, so it also governs the conduct of business and commerce. Muslims ought to conduct their business activities in accordance with the requirement of their religion to be fair, honest and just towards others" (p. 108).

2.4 The Accounting Profession

According to Markell (1985), the accounting profession in a developing country, as in the case of Libya, is largely dependent on its accounting educational system; for the profession to be developed it is also obvious that developing or creating the proper accounting education system would be of great assistance, he indicated:

> "For an accounting system to be implemented on a continuing basis, an accounting profession must exist. In a new or developing country, the accounting profession can be developed or created in one of two ways. It can develop appropriate educational institutions to prepare individuals to enter the accounting profession. Obviously, this approach would require much time to prepare individuals to the desired level of competence. The second and simpler alternative, especially in the early stages of a nation's development, is to create an instant profession" (p. 99-100).

Accounting practices in Libya have been influenced by a number of factors, one of which is the accounting education system (Mahmud and Russell, 2003). It has been also influenced by Western accounting: "applied accounting principles and auditing standards in Libya follow those of the U.K. and the U.S" (Mahmud and Russell, 2003. p. 201)[23]. Another factor that may have had an influence over the accounting profession in Libya as identified by Ahmed and Gao (2004) is the oil discovery. Since the late 1950s, when oil was discovered, the development of economic activities in Libya has resulted in more reliable accounting information becoming required for many users including management, investors, and government (El-Firjani, 2010).

[23] As discussed earlier in this chapter, the accounting education system was primarily based on UK and US systems; therefore, it is logical that the accounting profession is influenced by both UK and US practices. Practitioners are the products of the education system as emphasised by Ahmed and Gao (2004) who suggest that the educational system is the first stage in the qualifying accountants process.

According to Wallace (1990), accounting systems in developing countries, like Libya, are regarded as poor; he lists the shortfalls of the accounting systems of the developing countries as follows:

> "Many weaknesses have been noted in the financial accounting and reporting systems of developing countries – poor internal control, lack of management accounting concepts, incomplete, inaccurate and late reports as well as unauditable systems and shortage of staff, unreliability, inadequacy of financial accountancy, rudimentary and offering management little or no vital information, and irrelevant and deficient reporting" (pp. 38-39).

The accounting profession in Libya was governed for the first time by Law No. 116 that was enacted in 1973[24],[25] by which the LAAA was established. The ability to supply audit services is restricted to LAAA members. Membership of the association requires that a candidate is a Libyan who has an accounting degree and who has experience of five years in an accountancy-related job after gaining their degree (Ahmed and Gao, 2004). This law covers many issues relating to the accounting practices in the country; the LAAA is the only responsible body to act with legal status in the area of auditing on behalf the State; moreover it "manages every facet of the auditing profession" (Ritchie and Khorwatt, 2007, p. 41). Ahmed and Gao (2004) summarised the objectives of the law as follows:

> "(i) to organise and improve the conditions of the accounting profession and to raise the standards of accountants and auditors professionally, academically, culturally and politically; (ii) to organise and participate in conferences and seminars related to accounting internally and externally and to keep in touch with new events, scientific periodicals, lectures and so on; (iii) to establish a retirement pension fund for its members; (v) to increase co-operation between its members and to protect their rights; and (vi) to take action against members who violate the tradition and ethics of the profession" (p. 369).

[24] Before 1952 when Libya gained its independence, there was no national accounting body nor accounting firms, business firms at that time were served by foreign accounting firms from Italy and UK (Ahmed and Gao, 2004).

[25] During the 1950s and 1960s, most of the accounting firms which worked in Libya were either British or American; Libyan accounting firms have existed only since 1970 (Mahmud and Russell, 2003).

Mahmud and Russell (2003) concluded that the LAAA had failed to achieve its objectives, for example, to establish or participate in research, conferences, and seminars or any activity that may have an influence over the profession's development. It had, according to Mahmud and Russell (2003), failed even to regulate itself let alone pursue its responsibility towards the public interest. Another critique of the LAAA by Mahmud and Russell (2003) was that the LAAA did not yet have a code of ethics; they concluded:

> "Although, the LAAA was formed more than two decades ago it has done nothing to build any theoretical base for accounting to be a profession in Libya and it has not established a code of ethics for its members to abide by" (p. 201).

In addition to the above critiques, Mahmud (1997) points out that the LAAA has failed to either organise or participate in any programmes that would develop the profession; in addition it was, at that time, unsuccessful in updating the profession about recent developments. He concludes based on the above, that the accounting profession in Libya was very weak[26]. In a recent study, El-Firjani (2010) concluded that the LAAA had no impact on the accounting profession in Libya. More particularly, the LAAA has failed to develop accounting practices. He added that accounting practices in Libya are mainly dependent on the laws and regulations. It is worth noting that the LAAA attempted in 2006 to prepare national accounting standards by issuing for the first time the first Exposure Draft of a number of Libyan Accounting Standards (EDLASs). This draft consisted of 29 accounting standards mainly based on IFRS/IAS. However, due to weakness in the enforcement system, this draft is still not mandatory (El-Firjani, 2010). The accounting profession, according to El-Firjani (2010), is still immature as it is:

> "still in its early stages of developing corporate accounting practices and it appears to play no important role in retaining external influences on the accounting practices" (p. 208).

[26] This situation is still remaining and may be even worse. The LAAA is still facing difficulties as, for example, the Benghazi branch is almost inactive due to its main location being occupied during the revolution by foreigners as the author is aware of.

2.5 Summary

This chapter has provided a background about Libya. Local environmental factors that are believed to impact accounting practices in Libya have been outlined so that empirical evidence can easily be contextualised. The political system in Libya has been discussed briefly to view the different stages that Libya has encountered. The legal system which embodies the local codes that have either direct or indirect impact on the accounting practices of the Libyan Commercial Banks have been outlined and discussed in a bit more detail. The accounting system educational process which unquestionably influences the accounting practices in Libya has been highlighted, as well as the role of religion in a Muslim country in terms of how accountability should be viewed. Then came a short overview of the accounting profession's status in Libya which is organised by the LAAA body. Having discussed the environmental factors in Libya, the next chapter provides a literature review about the earnings management phenomenon.

Chapter 3

Literature Review

3.1 Introduction

In Chapter 1, a broad overview of the thesis was provided. This chapter will review the literature to address the definition and practice of earnings management. Earnings management techniques as well as the relationship between earnings management and fraud will also be discussed. Managers' motivations to engage in earnings management will also be outlined. Two common forms of earnings management will be highlighted: income smoothing and big bath accounting. Then, major parties that are potentially influenced by earnings management decisions will be focused on. The ethics of earnings management is also discussed followed by an analysis of the approaches to detecting earnings management. Finally the question of earnings management in the banking industry will be considered.

(IAS) 1 *Presentation of Financial Statements* (IASB, 2010a) prescribes the basis for the presentation of "general purpose financial statements" and sets out the financial statements that an entity should prepare and present, including a statement of comprehensive income for the period. The objective of financial statements, according to IAS 1, is to provide information about the financial position, cash flows and economic performance of the firm to a large range of users to help them in their economic decisions. This was made clear in the IASB's Conceptual Framework for Financial Reporting (IASB, 2010b) which states:

> "The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity" (IASB, 2010b, para. OB2, p. A27).

Furthermore, financial statements reflect management's stewardship of the resources entrusted to it. In order to achieve these objectives, financial statements should be prepared according to the accrual basis of accounting (IASB, 2010a).

The IASB's Conceptual Framework has also demonstrated how to record financial transactions under the accrual basis of accounting as follows:

> "Accrual accounting depicts the effects of transactions and other events and circumstances on a reporting entity's economic resources and claims in the periods in which those effects occur, even if the resulting cash receipts and payments occur in a different period".(IASB, 2010b, para. OB17, A29).

In addition, the Conceptual Framework has outlined the significance of booking the financial transaction on an accrual basis for assessing the entity's performance, it has stated:

> "This [accrual basis] is important because information about a reporting entity's economic resources and claims and changes in its economic resources and claims during a period provides a better basis for assessing the entity's past and future performance than information solely about cash receipts and payments during that period" (IASB, 2010b, para. OB17, A29).

The accrual basis of accounting has an important distinguishing characteristic, and that is subjectivity. For companies that comply with International Generally Accepted Accounting Principles (GAAP) and that are a going concern, it is mandatory to record and report financial transactions according to the accrual basis of accounting so that financial statements should reflect a true ad fair view of the financial position of the firm.

The US Financial Accounting Standards Board (FASB) has outlined the objective of accrual accounting; Statement of Financial Accounting Concepts No. 6 states:

> "Accrual accounting uses accrual, deferral, and allocation procedures whose goal is to relate revenues, expenses, gains, and losses to periods to reflect an entity's performance during a period instead of merely listing its cash receipts and outlays. Thus, recognition of revenues, expenses, gains, and losses and the related increments or decrements in assets and liabilities –including matching of costs and revenues, allocation, and amortization- is the essence of using accrual accounting to measure performance of entities. The goal of

accrual accounting is to account in the periods in which they occur for the effects on an entity of transactions and other events and circumstances, to the extent that those financial effects are recognizable and measurable" (FASB, 1985, para. 145, p. 35).

The accrual accounting system requires managers to exercise discretion and judgment when they are preparing financial statements and such judgements will affect the reported income and valuation of an entity's performance. Managers are expected to choose accounting rules that are appropriate for reflecting economic reality[27] and to ensure that annual financial statements give a true and fair view. However, choosing accounting policies to fulfil other objectives constitutes "earnings management" (Mulford and Comiskey, 2002).

Thus, the earnings figure depends, to some extent, on managers' decisions and the decisions they made to reflect a company's performance from its business activities (Mulford and Comiskey, 2002). The reported earnings figure is "widely used as a key performance indicator of business success" (Holland and Ramsay, 2003, p. 42), which according to McKee (2005, p. 1), represents "the single most important item in financial statements"; given that importance, managers may have some interest in manipulating this figure (Baralexis, 2004; McKee, 2005).

Ronen and Yaari (2008) argue that earnings' importance stems partially from the importance of accounting information given that accounting information is traditionally viewed as having a dual role: informativeness and stewardship. They argue that the informativeness role of earnings is well documented by the literature which reveals a marked relationship between earnings and share price. On the other hand, the stewardship role of accounting that results from the separation between management and owners implies a potential conflict of interest between the two parties. In this regard, Watts and

[27] The argument that "in describing reality we construct reality" (Hines, 1988) is acknowledged but goes beyond the scope of this chapter.

Zimmerman (1978, cited in Ronen and Yaari 2008, p. 7) suggest that “one function of financial reporting is to constrain management to act in the shareholders’ interest”.

The subjectivity that is inherent in accruals accounting opens the door for managers to manipulate the reported earnings numbers (Razzaque et al., 2006). Such accounting manipulation has been practiced by mangers for a very long time, and this behaviour has been given various names in the literature[28] e.g. creative accounting, earnings management, income smoothing, big bath accounting and window dressing. Accounting manipulation has a long history with references in the literature dating back to at least 1893. Naser (1993, cited in Baralexis, 2004) states that creative accounting as a manipulative behaviour goes back to the 1920s. To Heinz et al. (2013) accounting manipulation is "a longstanding issue" that dates back to the beginning of accounting (p. 299). However, such behaviour had been identified before as “income smoothing” and according to Buckmaster (2001) income smoothing was identified in the literature as early as 1893.

Creative accounting comprises earnings manipulation and other forms of accounting manipulation that can be implemented within or outside of the procedures allowed by GAAP. Jones (2011) has in this respect stated that, the term “creative accounting” is interpreted differently in the UK and the US. According to Jones (2011), accounting manipulation within GAAP limits is known as “creative accounting”[29] but when it is implemented outside of GAAP boundaries it is considered as accounting fraud. Creative accounting in the UK context thus can be defined as:

[28] The literature is constantly giving new names for this practice. It has been described as “Alice in Wonderland” accounting (Wilson, 2012).

[29] Creative accounting and other related terms have been used interchangeably with the term earnings management (McKee, 2005, p.3). For some, earnings management and creative accounting are synonyms which are used depending on geographic location; creative accounting as a term is commonly used within Europe while earnings management has been used particularly in the American context (Amat and Growthorpe, 2004.).

> "Using the flexibility in accounting within the regulatory framework to manage the measurement and presentation of the accounts so that they give primacy to the interest of the preparers not the users" (Jones, 2011, p. 6).

Based on the definition above it can be seen that creative accounting can be regarded as lawful and legitimate as it works within the limitations of both law and accounting standards. However, creative accounting is undoubtedly in conflict with spirit of accounting standards; where the spirit of GAAP is to reflect the economic results of transactions to meet the needs of users; the purpose of creative accounting is to meet the needs of preparers (Jameson, 1990).

In the US context, by contrast, Mulford and Comiskey (2002) offered a definition of creative accounting as follows:

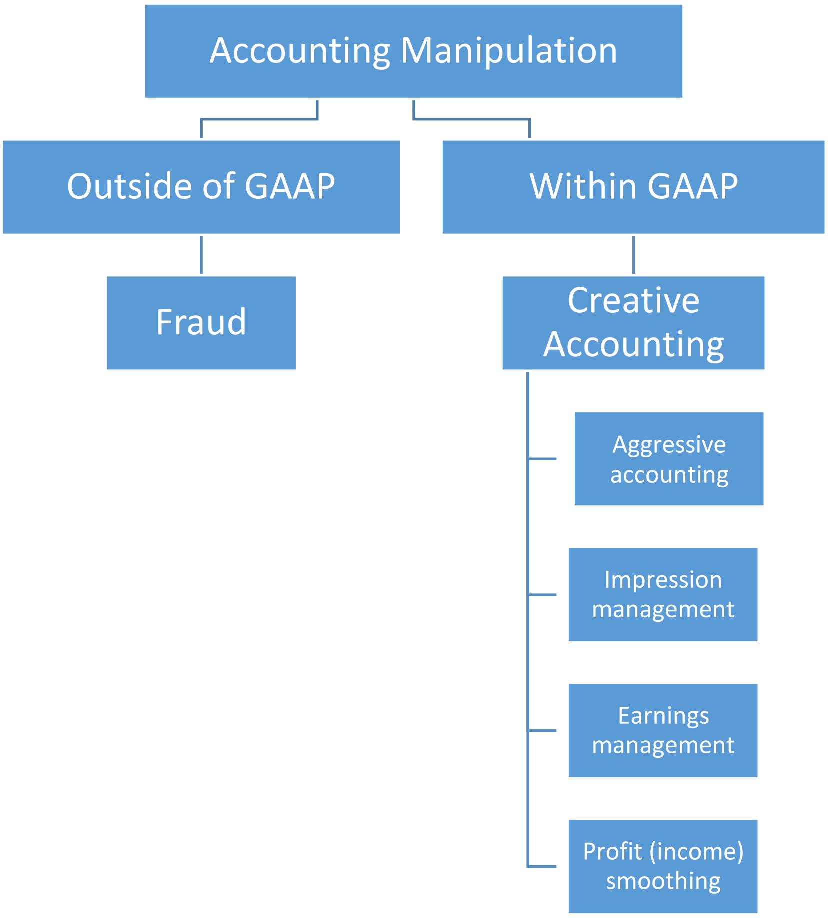
> "Any and all steps used to play the financial numbers game, including the aggressive choice and application of accounting principles, both within and beyond the boundaries of generally accepted accounting principles, and fraudulent financial reporting" (p. 15).

Mulford and Comiskey (2002), argue that the "financial numbers game" is played solely to change reported financial results and/or to modify the financial position so as to generate desired amounts and/or some desired direction and could be accomplished through available means of accounting choices, accounting policy application, transactions construction, or finally by absolute fraudulent reporting that is outside of GAAP and corporate law.

Clearly therefore, a fundamental difference between the above two definitions of creative accounting is that while the UK definition considers creative accounting as legitimate and lawful i.e. practices that take place within the boundaries of GAAP, the US definition states that creative accounting includes accounting fraud which is beyond GAAP and the law.

For the purpose of this thesis, unless stated otherwise, the term creative accounting will be used in accordance with UK usage i.e. to exclude fraud, see Figure 3.1.

Figure 3.1: Accounting Manipulation



Adaptation of a (UK context) categorisation of creative accounting terminology (Jones, 2011, p.9). (It should be noted that the categories are not mutually exclusive).

An overview of the terminology used to describe accounting manipulation and creative accounting is given in Figure 3.1 According to Jones (2011) the term "aggressive accounting" is broadly seen to be synonymous with the general meaning of creative accounting. To Mulford and Comiskey (2002) aggressive accounting implies an accounting choice or application that has been deliberately adopted to realize higher earnings no matter whether this application is within or outside GAAP[30]. Although impression management might be considered an aspect of creative accounting, it is not normally associated with manipulating accounting rules; impression management is

[30] Another distinction between UK and US definitions. Aggressive accounting is lawful in the UK context while it could be out with the scope of GAAP within the US context.

typically used to influence users of financial statements through presentational aspects of associated narrative reporting, graphs and photographs (Jones, 2011). In the words of Brennan et al. (2009), impression management is defined as "the process by which individuals attempt to control the impression of others" (p. 790). They also add that in the financial reporting context, impression management is taking place when "management select information to display and present that information in a manner that distorts readers' perceptions of corporate achievements" (p. 790). Although Jones (2011) shows earnings management and profit smoothing separately, it is arguable that profit smoothing is a form of earnings management. This chapter will discuss the definition of, and incentives for, earnings management and two examples of earnings management; income smoothing and big bath accounting.

3.2 Earnings Management Definition

Financial reporting represents the means by which managers are able to communicate information about their firm's performance to the users. In the preparation of financial reports, managers are given some room to exercise their own judgement to determine the amount of some figures e.g. the provision for bad debts (Holland and Ramsay, 2003). Although this flexibility provides managers with the opportunity to make accounting estimates based on their "knowledge of the business" which may increase the financial information's usefulness, it also opens the door for earnings management (Holland and Ramsay, 2003, p. 42).

According to Mohanram (2003) earnings management has become a significant issue in today's stock markets; "[h]ardly a day goes by without mention of a large firm that misled investors through the intentional misstatement of the financial statements" (p.1). He also, added that it is of great importance for investors and other stakeholders to understand what earnings management is, what the consequences are and why it happens (Mohanram, 2003). Nelson et al. (2003) suggest that a better understanding of earnings management could: (a) help regulators and standards setters to identify weak areas that need to be tightened; (b) assist auditors in evaluating and reporting on earnings quality as well as training newly qualified auditors about earnings management; (c) enable CEOs, CFOs, audit committees, and investors to focus on areas of the financial statements where they should be most sceptical; (d) facilitate managers and audit committees anticipating areas that investors will put under scrutiny; (e) help educators teach the subject; and (f) encourage researchers to focus on understanding the reasons for and implications of earnings management.

Earnings management has been recognised as an attempt by managers to influence financial statements by using specific accounting methods to achieve some self-interested goal (Akers et al. 2007). However, there is no clear agreement in the literature on how earnings management can be defined (Beniesh, 2001). Various authors use various definitions of earnings management and also different expressions to describe the same phenomenon, a phenomenon that is considered to be widespread in the financial statements (Levitt, 1998; Dechow and Skinner, 2000; McKee, 2005). Griffiths (1992) in his book entitled "Creative Accounting" started his first chapter by asserting that all UK companies have manipulated their accounts:

> "Every company in the country is fiddling its profits. Every set of published accounts is based on books which have been gently cooked or completely roasted. The figures which are fed twice a year to the investing public have all been changed in order to protect the guilty" (p. 1).

As stated above, earnings management has been defined in different ways; for example a widely cited definition is given by Healy and Wahlan (1999):

> "Earnings management occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company, or to influence contractual outcomes that depend on reported accounting numbers" (Healy and Wahlen, 1999, p. 368).

Another definition was given by Davidson et al. (1987 cited in Schipper, 1989):

> "The process of taking deliberate steps within the constraints of generally accepted accounting principles to bring about a desired level of reported earnings" (p. 92).

Schipper (1989) defined earning management as follows:

> "…a purposeful intervention in the external financial reporting process, with the intent of obtaining some private gain (as opposed to say, merely facilitating the neutral operation of the process)…" (Schipper, 1989, p. 92).

Arther Levitt, the former SEC chairman in his 1998 speech "Numbers Game" (Levitt, 1998) spoke emphatically about his concern over the observable fact that managers manipulate reported profits to meet analysts' expectations. He added that flexibility in accounting permits it to keep up with business innovations. In what could be regarded as a definition of earnings management, Levitt describes:

> "…a gray area where the accounting is being perverted; where managers are cutting corners; and, where earnings reports reflect the desires of management rather than the underlying financial performance of the company" (Levitt, 1998. p. 14).

Levitt believes that the motivation to meet Wall Street earnings expectations might be an overriding "common sense" business practice and that many corporate managers, auditors, and analysts have a role, in one way or another, in this game. Levitt made explicit his fears that the financial community is "witnessing an erosion in the quality of earnings" which may lead to an erosion in the quality of financial reporting. Moreover, he argued that earnings management may open the door for manipulation, integrity may be losing out to illusion and that integrity in financial reporting is under stress.

Earnings management according to Levitt is the exercise of accounting in the gray area between legitimacy and outright fraud; an area where accounting is being used to have financial reports represent management desires instead of the "real economic performance" of the firm. Levitt suggests that earnings management, as a problem of the financial community, could be solved by efforts of financial community members. These efforts, according to Levitt, include improving both accounting and disclosure rules, as well as oversight and the function of external auditors and audit committees. In the view of Levitt, the failure to provide investors with unbiased disclosures about a firm's performance will weaken the bond between shareholders and the firm. This will affect the basic element underpinning the effective operation of any stock market, and that is trust.

According to Beneish (2001), earnings management has been implicitly considered as a central issue in accounting research; during the 1970s and early 1980s a great deal of research was conducted to investigate the determinants of accounting choices. Lo (2008) argues that the topic of earnings management might provoke interest as it is an accounting issue that implies "potential wrongdoing, mischief, conflict, cloak and dagger, and a sense of mystery" (Lo, 2008, p. 350).

Clearly, a number of authors are of the view that preparers of financial statements practice earnings management by selecting favourable accounting policies and practices to report within, or even beyond, regulatory and contractual contexts. According to Beneish (2001) research on earnings management that has been carried out since the mid-1980s has mainly been concerned with investigating how accruals accounting can be used to manipulate financial statements. He also suggests that this focus on accruals accounting research is principally related to three factors. First, accrual accounting is a central characteristic of GAAP and management would prefer to manage earnings through accruals rather than cash flow elements of earnings. Second, studying accruals could lead to a reduction in the problems that relate to an "inability to measure the effect of various accounting choices on earnings". Finally, given that earnings management is unobservable, it is unlikely that investors will be able to undo the managed reported earnings (Beneish, 2001, p. 3).

According to the previous definitions, the practice of earnings management implies management's intent to mislead some stakeholders about a company's performance by using their knowledge of the accounting rules, or economic decisions so they can achieve some self-interested benefit. In addition, the previous definitions imply that managers can use their judgement when choosing accounting methods to account for an event. Accounting choices e.g. depreciation methods, inventory valuation, etc. will affect the reported earnings of the company. Also, definitions explicitly emphasise that earnings management is practiced mainly to mislead stakeholders.

Revisiting the definition of Healy and Wahlan (1999) it might be noted that they identify two broad kinds of earnings management namely accounting earnings management and economic or real earnings management. Accounting earnings management "uses judgement in financial reporting" which implies using the accounting choices so as to manage earnings; by contrast economic earnings management means "structuring transactions" which is achieved through real business decisions. In the words of Zhao et al. (2012), real earnings management is a departure from the normal operational practices by manipulating real activities in order to achieve a "primary objective" that is typically inflating near-term earnings.

The significant difference between real earnings management and accrual-based earnings management, according to Cohen and Zarowin (2010), is the direct effect on cash flows that real earnings management entails. While accrual-based (accounting) earnings management, according to Zhao et al. (2012), "affects the output of the accounting system without no direct cash flow consequence" (p. 110).

Whatever the way used to affect the reported earnings, all decisions that are taken by management for no other reason but to change the reported earnings can be considered as an earnings management practice (Mohanram, 2003).

3.3 Earnings Management Techniques

Earnings management techniques vary according to earnings management types; accounting earnings management clearly uses different methods from those used by economic earnings management. Ortega and Grant (2003), classified the accounting earnings management techniques that can be used by firms as follows: (a) premature revenue recognition, where management could record revenues early in order to boost current earnings; (b) operating expense timing, where management may delay expenses to the next year if the company is experiencing low performance; and (c) unrealistic assumptions to estimate liabilities, for example if management manipulate their liabilities estimation on current year performance and if current year performance is low then management may make an unrealistically low estimate, say for the bad debt allowance, and by contrast when economic performance is doing well, management may tend to use high estimates for liabilities allowances. By contrast, economic earnings management uses real operating decisions, where business decisions are taken in the normal course of the business, for example, when sales are below average, management could decrease prices so as to raise sales volume in an attempt to reach the targeted earnings (Ortega and Grant, 2003). Another example of economic earnings management is provided by Bartov (1993) who concludes that managers manipulate reported earnings through selling fixed assets and investments. In their study of more than 400 executives, Graham et al. (2005) concluded that economic or real earnings management is the preferred type by managers, as they point out that “most earnings management is achieved via real actions as opposed to accounting manipulation” (p. 66). However, such a practice could affect the “firm’s long-term interest” and therefore, it might be costly (Man and Wong, 2013, p. 400). Real earnings management, according to, Zhao et al. (2012), “is more likely to entail substantial costs to shareholders” as it implies that the firm sacrificing its “longer-term cash flows” (p. 112).

Beneish (2001) has identified two perspectives on earnings management; these are the “opportunistic” and “informative” perspectives. An opportunistic perspective implies that managers are engaged in earnings management practices mainly to mislead investors by pursuing their interests. This perspective was noted by Healy (1985) who has concluded that managers engage in accounting earnings management (through accruals) mainly to influence their compensation, he has indicated that management compensations “create incentives for managers to select accounting procedures and accruals to maximize the value of their bonus awards” (Healy, 1985, p. 106).

An informative perspective, according to Beneish (2001), suggests that management, through income manipulation, release their own assessments of prospects for the future performance of the company to investors. Based on their perspectives, managers will reveal their personal beliefs regarding the firm’s future cash flows maximising the firm’s value.

Based on the above discussion it could be noted that, notwithstanding the “informative perspective” earnings management typically has a negative connotation. When managing earnings, managers are exploiting their knowledge of GAAP as well as their firms and constructing business transactions or making accounting choices so that they can get some private benefit. According to Holland and Ramsay (2003), the negative connotation attached to the term earnings management stems basically from the implications of the term itself. They conclude that “the term earnings management implies management opportunism and/or an intention to mislead, giving the term negative connotations” (p. 42).

In addition to the negative connotation, earnings management has been described by Nelson et al. (2002) as “non-neutral financial reporting” in which managers are deliberately altering the reported income to achieve some private gain. It has been also described as a “slippery slope that would lead to fraudulent financial reporting” (Ortega and Grant, 2003, p. 51). Abdelghany (2005) characterises earnings management as “minor accounting gimmicks becoming more and more aggressive until they create material misstatement in the financial statements” (p. 1002). The exercise of earnings management may potentially lead to adverse consequences; according to Loomis (1999), earnings management may entail a legal penalty. He has described how earnings management may appear to be effective:

> "Until it is uncovered. The company's stock will drop then, by a big percentage. Class-action lawyers will leap. The Security and Exchange Commission will file unpleasant enforcement actions, levy fines, and leave the bad guys looking for another line of work. Eventually someone may go to jail" (p.).

Beaudoin et al. (2013) acknowledge the conflict of views regarding the acceptability of earnings management. They indicate that some scholars view it as an unethical practice that lead to negative consequences, it is also suggested by others as an inherent result of the financial reporting process and that is does not affect the usefulness of accounting information.

Looking at earnings management from a preparer's position might lead to a different perspective. Parfet (2000) differentiates between two types of earnings management; bad earnings management or improper earnings management and good earnings management or operational earnings management. Bad earnings management is where a manager uses accounting earnings management to hide real operating performance, while good earnings management is where a manager constructs actions to improve their firm's financial performance. Parfet defended this type of earnings management and described it by saying "this is just the business of business" (p. 485).

3.4 Earnings Management and Fraud

When accounting numbers are manipulated, or in other words a financial game is played, either by choosing from a range of accounting choices or by stretching the application of these choices to use them in an aggressive manner, then this can be called "aggressive accounting". If this aggressive manner is carried out beyond the limits of GAAP, a financial fraud is committed and then the financial statements do not present a fair view of the financial position and performance of the reporting entity. Although, this will be known only in "hindsight", however, there will be a necessity for adjustments (Mulford and Comiskey, 2002). Fraudulent financial reporting has an extra aura of disgrace and is regarded as outright dishonesty rather than aggressive accounting. It is not easy to determine the point at which aggressive accounting becomes fraudulent. However, aggressive application of accounting choices when it is practiced for an extended period and involves substantial sums may end up becoming fraudulent financial reporting. Although identifying fraudulent financial reporting is guided by the extent to which aggressive accounting is exercised and the supposed intent of the management, determining what is the point after which aggressive accounting becomes fraudulent is more art than science (Mulford and Comiskey, 2002). The aggressive practice of earnings management, according to Chen et al. (2012), may lead to fraud. They indicate that "financial statement fraud often originates from a slippery slope of increasingly aggressive earnings management" (p. 95).

According to Griffiths (1986), it is not easy for financial statements users to distinguish between creativity and fraud as there is a very thin line separating them and stating whether a practice is creative accounting or fraud ultimately is a matter for the courts to decide (Brown 1999, cited in Al-khabash and Al-Thuneibat, 2009).

Fraud is a "wrongful or criminal deception intended to result in financial or personal gain" (Online Oxford Dictionary). Also fraud can be defined according to the National Association of Certified Fraud Examiners (cited in Ortega and Grant, 2003), as:

> "The intentional misstatement or omission of material fact, or accounting data, which is misleading and, when considered with all the information made available, would cause the reader to change or alter his or her judgment or decision" (p. 52).

As discussed above, earnings management practice, within GAAP is lawful and allowed by accounting standards and corporate laws; it has to be distinguished from fraud in the financial statements. However, despite the fact that earnings management may be legitimate, it may be rather destructive, as according to the National Commission on Fraudulent Financial Reporting (cited in Merchant and Rockness, 1994. p. 80), earnings management actions can deceive users' of financial statements and moreover, they could be "pre-cursors" of financial fraud. Although earnings management and financial fraud are different things, in terms or legality, they share the same starting point. Magrath and Weld (2002) reveal that:

> "… the accounting irregularities at Lucent, Cendant, and MicroStrategy were primarily abusive earnings management schemes or outright fraud, all three companies began their abusive and fraudulent practices by engaging in earnings management schemes designed primarily to smooth earnings to meet internally or externally imposed earnings forecasts and analysts' expectations". (p. 51).

Earnings management might be used by companies that are facing difficulties in order to promote their financial situations. However, this may not succeed and moreover could lead to the committing of fraud. Griffiths (1992) argues:

> "All that it [earnings management] can do is to defer and mitigate the bad news until there is a revival in trading fortunes. It cannot make bad news look good in perpetuity without resorting to out-and-our fraud" (p. 5).

Dechow and Skinner (2000) distinguished between fraud and earnings management and provided the illustration below (see Figure 3.2):

Figure 3.2: The Distinction between Fraud and Earnings Management

	Within GAAP
"Conservative" Accounting	- Overly aggressive recognition of provisions or reserves. - Overvaluation of acquired in-process R&D in purchase acquisition. - Overstatement of restructuring charges and asset write-offs.
"Neutral" Accounting	- Earnings that result from a neutral operation of the process.
"Aggressive" Accounting	- Understatement of the provision for bad debts. - Drawing down provisions or reserves in an overly-aggressive manner.
	Violates GAAP
Fraudulent Accounting	- Recording sales before they are "realizable". - Recording fictitious sales. - Backdating sales invoices. - Overstating inventory by recording fictitious inventory.

Source: Dechow and Skinner (2000, p. 239).

Earnings management does not have to take the form of increasing profit. As will be discussed in the following paragraph the practice could take the form of decreasing the current net income; the reasons behind this practice have been called earnings management incentives and are discussed hereafter.

3.5 Managerial Incentives for Earnings Management

Incentives represent the rational basis for earnings management practice; without those incentives, managers should not be deterred from choosing accounting judgments and methods that fairly represent the economic performance of the firm. In many cases, managers may find themselves in situations in which they are tempted to manipulate the reported profits because the firm's value and mangers' wealth are associated with the reported earnings (Jackson and Pitman, 2001). Despite the fact that earnings management is widespread (Levitt, 1998), it is difficult for researchers to document it with credible proof as verifying whether earnings have been managed is not an easy task.

Identifying the manger's incentives to manage earnings and estimating whether patterns of otherwise unexpected accruals are consistent with these incentives could help (Healy and Wahlen, 1999). Four kinds of incentives have been identified as inducing managers to be involved in earnings management: external contract incentives; management compensation contract incentives; regulatory and political motivations; and capital market motivations (Noronha et al., 2008). These motivations are briefly discussed in the following section.

3.5.1 External Contract Incentives

Some external contracts, for example debt contracts, dividend covenants and supplying contracts contain provisions by which a company agrees to reach a certain level of earnings, debt, or limit payments to the shareholders (Noronha et al., 2008). When the company is close to violating one of the covenants[31], managers may be motivated to misrepresent the accounting data and therefore the reported earnings so they can meet the contract requirements and avoid default by increasing the reported income (Noronha et al. 2008; Duncan, 2001; Jackson and Pitman, 2001). Some lending contracts are based on accounting numbers and designed in a way to restrict certain types of managers' decisions e.g. "value-reducing investment and financing decisions" which, according to Watts and Zimmerman (1986, p. 210), provide incentives to managers for accounts manipulation. They hypothesized that managers are expected to manipulate earnings when a "firm's debt/equity ratio" (p. 216) becomes relatively large. The literature reports other evidence that firms which are close to lending covenant limits are engaged in earnings management, for example Defond and Jiambalvo (1994 cited in Noronha et al., 2008) in their study found that firms did accelerate earnings in the year prior to a covenant violation. Iatridis and Kadorinis (2009) found out that UK listed firms which are close to debt covenant violations employ earnings management practices in order to not default the covenants.

3.5.2 Management Compensation Contract Incentives

Accounting figures represent the basis to control and regulate contractual relationships among a company's stakeholders; management compensation is such a relationship (Healy and Wahlen, 1999). Companies may link the bonus programmes of managers with their economic performance in order to bring into line management's' goals with those of shareholders which in return provides a very strong incentive for managers to employ the reported earnings to increase their compensation payments (Duncan, 2001). Healy (1985) blamed management compensation for creating incentives that induce managers to engage in earnings management. Management compensation which is regarded as the "primary incentive for earnings management" (Achilles et al., 2013, p. 581) is basically placed to

[31] The focus of this chapter is earnings management; some creative accounting techniques could have an effect on balance sheet values but are not regarded as earnings management due to the absence of an earnings effect. Attempts to meet covenant requirements could be one such example.

combine both managers' and shareholders' interests as these two groups' interests can be conflicted (Wolk et al., 2008). However, according to Watts and Zimmerman (1986), managers of firms with earnings-based bonuses are expected to manipulate the reported earnings to their own advantage. In the UK, listed firm managers, according to Iatridis and Kadorinis (2009), are improving their financial numbers through earnings management practices so that their compensation is protected or increased.

Mangers may also attempt to manipulate reported income out of concern for job security. When current earnings are low while next year's profit is expected to be relatively high, mangers may advance some earnings from the next period to the present and in contrast when the current year's profit is high and next year's earnings are expected to be low, mangers may also shift some earnings to the next year. Moreover, managers typically believe that reporting a growing steady stream of income is highly appreciated by financial analysts (Jackson and Pitman, 2001). In addition, individuals may be motivated to get a promotion based on the fact that people may be very obsessed with climbing the corporate ladder; this aspect along with a company policy to reward ambitious persons, means that seeking or gaining a promotion can be an incentive to manipulate earnings (Duncan, 2001).

3.5.3 Regulatory and Political Motivations

Regulatory incentives to manage earnings may be very significant in cases where reported earnings will affect the procedures of regulatory or government officials. Commercial banks in Libya, for example, are monitored by the Central Bank of Libya for compliance with regulation and in such a case, managers may be motivated to manipulate the reported earnings in order to avoid the actions that could be taken by such a governmental and regulatory body (Jackson and Pitman, 2001). Moreover, some banking regulations require banks to maintain a certain minimum level of capital adequacy requirements that are represented in the form of accounting figures. Such regulations may tempt managers to manipulate these figures to meet the requirements (Healy and Wahlen, 1999).

In addition, tough taxation laws may induce firms to manipulate their reported income. According to Watts and Zimmerman (1986), managers are motivated to manipulate the reported earnings to avoid political costs, they hypothesised that managers are more likely to manage the reported earnings downwards to lessen the tax expenses. Baralexis (2004) found out that small firms in Greece employ earnings management to gain tax savings. Likewise, Gonchanalyze and Zimmermann (2006) tested the earnings management practices of Russian companies in the years 2001 and 2002 to find out that Russian companies lessen their reported income in order to reduce income taxes.

3.5.4 Capital Market Motivations

Meeting revenue expectations and analysts' predictions may be the main catalysts that induce managers to manipulate earnings (Magrath and Weld, 2002). The capital market incentive stems basically from the connection between reported earnings and a company's market value, due to the fact that stock markets typically respond negatively to companies that fail to meet analysts' earnings expectations. Companies which are not reaching these predictions may be involved in earnings management to satisfy analysts' expectations (Jackson and Pitman, 2001). Eventually, failing to meet analysts' expectations can lead to adverse consequences on a company's stock price e.g. when Procter & Gamble declared that the company would not reach the analysts' forecast in the first quarter of 2000, its stock price decreased by 30% (Duncan, 2001). Literature suggests that managers are concerned about meeting or beating the analysts' expectations and that it is a "fundamental" target since stock market severely reacts to negative reported earnings (relative to expectations), moreover, the positive earnings (relative to expectations) are rewarded which, according to Athanasakou et al. (2009) gives managers a strong incentive to manipulate the reported earnings.

Glaum et al. (2004), for example, compared the earnings management incentives of US and German firms; they found that both U.S. and German firms are managing their earnings to avoid losses and decreases in earnings. Evidence was reported by Athanasakou et al. (2009) who examined UK firms' engagement in earnings management for the purpose of meeting analyst earnings expectations. Their findings suggest that UK firms tend to manipulate their income to meet the analysts' expectation and to avoid reporting negative earnings. Kamel and Elbanna (2010) examined the potential incentives for engagement in earnings management in Egypt to find out that Egyptian firms are mainly engaged in earnings management for the purpose of, among others, reporting profits and avoiding reporting losses as well as achieving high-share valuation.

3.6 Earnings Management Forms

In the following paragraph two popular forms of earnings management will be addressed: income smoothing and big bath accounting practices.

3.6.1 Income Smoothing

GAAP offers several methods to account for the same type of financial transaction, for example management can choose to depreciate an asset in numerous ways. Also management can time financial transactions e.g. delaying a sale. This flexibility opens the door for management to influence the reported income and thereafter to smooth reported income from year to year (Koch, 1981).

The term "income smoothing" refers to management's intervention to reduce the volatility of an income stream over time by transferring earnings from overweight years to underweight years (Copeland, 1968; Buckmaster, 2001). The accounting literature includes many definitions that describe management's behaviour in seeking to level the reported income. Such conduct can be defined as:

> "A means used by management to diminish the variability of a stream of reported income numbers relative to some perceived target stream by the manipulation of artificial (accounting) or real (transactional) variables" (Koch, 1981, p. 574).

Mulford and Comiskey (2002) give this definition for income smoothing:

> "A form of earnings management designed to remove peaks and valleys from a normal earnings series, including steps to reduce and "store" profits during good years for use during slower years" (p. 3).

The income smoothing objective is clearly defined by Sun and Rath (2011) as:

> "Income-smoothing is a specific form of earnings management which has a clear objective to reduce the temporal volatility of earnings and to produce a steadily growing stream of profits" (p. 127).

A very short definition was offered by Ronen and Sadan (1975) "… the dampening of the variations in income over time" (p. 62).

Having discussed the definition of income smoothing, the next section provides a brief description of how this practice has emerged.

During the first half of the twentieth century a considerable change in accounting took place; the emphasis on the information produced by financial statements transferred from the balance sheet to the income statement and this change was significant for some crucial accounting issues, one of which was income smoothing (Buckmaster and Jones, 1995). This view was informed by Hepworth (1953) who focused on the shifting concern of financial data users from the balance sheet to the income statement. Hepworth's article "Smoothing Periodic Income" is considered as one of the best known references in the literature pre-1954 (Buckmaster, 2001) and one of the most influential studies on income smoothing (Michelson et al. 2000). Although Hepworth did not offer a straightforward definition of income smoothing, some of his expressions are notable in describing the nature of the practice, for example '… considerable "juggling" of income may be accomplished by management decision as to the normality or abnormality of an item of revenue or expense…' (p.33). Hepworth was described as the first to mention that firms deliberately smoothed their incomes (Eckel, 1981).

According to Copeland (1968) the practice of income smoothing implies settling of accounting choices or reporting methods in a particular pattern continually so as to produce smoothed earnings. He set forth the features that a smoothing tool must employ in order to be used as a "manipulated smoothing device" which according to Copeland (1968) has to be holding the following characteristics:

> "(a) once used, it must not commit the firm to any particular future action; (b) it must be based upon the exercise of professional judgment and be considered within the domain of "generally accepted accounting principles"; (c) it must lead to material shifts relative to year-to-year differences in income; (d) it must not require a "real" transaction with second parties, but only a reclassification of internal account balances; and (e) it must be used, singularly or in conjunction with other practices, over consecutive periods of time" (p. 102).

3.6.1.1 Income Smoothing Types

Getting back to the definition of Koch (1981) a distinction can be made between two types of income smoothing; real (economic) income smoothing "represented by business decisions" and artificial (accounting) income smoothing "represented by accounting decisions" (Koch, 1981). Real smoothing results when management decide to commence or not to commence actual transactions or economic activities on the basis of their influence on reported profit (Eckel, 1981). Such activities e.g. offering big discounts at the end of a period, or hurrying or holding-up maintenance, in the end affect the cash flows as well as reported income (Fudenberg and Tirole, 1995). Artificial income smoothing does not affect the cash flows as management smooth income by manipulation of accounting rules e.g. shifting cost or revenue from one period to another or "shifting cost between expense and capital accounts"[32] (Eckel, 1981; Fudenberg and Tirole, 1995, p. 76). This affects the reported income of these periods while cash flows are not affected (Eckel, 1981).

Managers can reduce the volatility of the net income stream by creating secret reserves. These reserves are created in good years to be used in bad years to boost earnings, so that they dampen the fluctuation in reported income (Buckmaster, 2001). These reserves which

[32] Although this type is not affecting the cash flows, it may influence the cash flows indirectly via tax payments.

may also be known as “cookie jar reserves” (Levitt, 1998; McKee, 2005) and “secret reserves” (Buckmaster, 2001) are made by taking advantage of GAAP-based accrual accounting techniques where management can use these to achieve some benefits e.g. some financial transactions implying future obligations that according to GAAP must be estimated and recorded in the year the event occurred (McKee, 2005). In the estimation process managers will have to select only one estimate from a variety of options that are offered by GAAP and thus, for example, the highest estimation may be selected and as a result more expenses will be recorded in the current year and thereby fewer expenses will be recorded in future years (McKee, 2005).

3.6.2 Big Bath Accounting

In a listed company, the desired reward that a manager would normally prefer and work towards is the increasing of the company’s share price through increasing earnings, however, in some cases they would prefer to decrease the profit (Mulford and Comeiskey, 2002). This can be achieved through big bath accounting. Although the typical goal of earnings management is to avoid losses, big bath practice works the other way round; that is, when a company is really doing badly and definitely will incur and report losses, it may overstate the losses as much as possible. The main idea of big bath accounting is to inflate the loss and put bad news associated with poor earnings into the present fiscal year which will allow the boosting of earnings in future periods (Levitt, 1998; McKee, 2005). Possible motivations for engaging in big bath accounting are considered below. Mulford and Comiskey (2002) who described this form of earnings management as a “more flagrant” application give the following definition of big bath accounting:

> “A wholesale write-down of assets and accrual of liabilities in an effort to make the balance sheet particularly conservative so that there will be fewer expenses to serve as a drag on earnings in future years” (Mulford and Comiskey, 2002, p. 15).

In a bad year when earnings expectation has not been met, management may decide to write-down assets in an extensive manner, the point is that as long as it is already a bad year there may be no further consequences for making the results even worse by taking a "big bath", and such cleaning up of the balance sheet may result in smaller amounts of expenses to charge on earnings in subsequent periods (Mulford and Comiskey, 2002).

It is obvious that big bath accounting is a nonrecurring practice used to clean up the firm's balance sheet in order to reduce the expenses in future periods. Also, it is very common to observe "big baths" when a new management is appointed (McKee, 2005), so the current poor performance can be attributed to the previous management.

According to one of the first articles on "big bath" accounting by Moore (1973), the new management will benefit from big bath accounting in at least two ways. Firstly, reported low income will be attributed to old management and historical bases for future comparison will be lessened. Secondly, upcoming income will be free of these charges so that the earnings' trend should get better (Moore, 1973). Also managers are inclined to engage in big bath charges when earnings have had a major hit as analysts will look beyond a one-time loss and focus on future earnings (Levitt, 1998). Moreover, when earnings are already low, making them worse may mean little damage to both company's and management's reputations since the market may punish a firm in virtually the same way whether it encounters a big or small loss (Jordan and Clark, 2004). In addition, there are some other situations that may encourage big baths; e.g. operation restructuring, asset impairment, troubled debt restructuring and discontinued operations (McKee, 2005).

3.7 Earnings Management Related Parties

Numerous stakeholders are involved in, or affected by, earnings management decisions. According to Ronen and Yaari (2008) these stakeholders can be classified into three groups; management, users and monitors. Generally speaking, the link between all these stakeholders is the financial reporting; reports are generated by management, used by users and monitored by monitors (Ronene and Yaari, 2008). These groups might be affected by earnings management decisions in different ways where one group may consider a change in earnings as favourable while another group regards it as unfavourable (McKee, 2005). Those affected by earnings management decisions, have been described by Lo (2008) as victims. According to Lo (2008), the "potential victims of earnings management are, of course, the financial statement users" (p. 353). These users, according to Lo (2008), include "equity investors, bond investors, bankers, regulators, unions, suppliers, customers, and competitors" (p. 353).

In the following paragraph, this chapter will restrict attention to major stakeholders involved in the earnings management decisions; management (as preparers), auditors and regulators (as monitors) and investors (as users).

3.7.1 Managers

Creative accounting is a means by which managers can alter the financial statements. Theoretically, managers are appointed by shareholders in order to run the business on their behalf for the good of owners. However, literature documents that managers may use the flexibility granted by GAAP so as to manage the financial results in a light favourable to themselves (Jones, 2011). Managers have the vital role of producing and reporting on earnings. Theoretically it is the board of directors that sets forth the accounting policies, but in practice it is the managers who make the vital decisions e.g. operating, investment and financing decisions (Ronen and Yaari, 2008). As discussed earlier in this chapter there could be managerial incentives inducing managers to indulge in earnings management e.g. managers may increase the reported earnings in order to increase their compensation as they might be income-based or they may possess shares whose price is basically related to the company's earnings (Jones, 2011). Research on insider trading reveals that managers sell their shares when they are overvalued and in contrast buy shares when they are undervalued, benefiting from this asymmetry; managers could manage earnings in order to signal value related information or to conceal undesirable value related information (Ronen and Yaari, 2008). Jones (2011) points out three preconditions have to exist so managers can indulge in earnings management: the opportunity to manage earnings; the knowledge of how to do it; and the “pressure of acceptable self-verbalizations to convince themselves that their behaviour is morally acceptable” (Jones, 2011, p. 23).

3.7.2 Auditors

Auditors are assigned primarily to increase confidence that financial statements fairly represent the financial position of a firm. Earnings management may distort this "fair presentation" and be a real concern to auditors. Moreover, auditors will become more worried when management use questionable accounting practices (Jones, 2011). According to Stolowy and Breton (2004) auditors are dealing with two important objectives; satisfying the client and avoiding risk from third parties.

Given that creative accounting is lawful and legal when practiced withing GAAP and corporation laws, it is still a problematic issue to auditors as even if they spot the practice would feel worry as if they issue a qualified report that they may speed up the firm’s collapse since users will lose confidence. On the other hand, if they did not spot the practice of creative accounting or fraud then their reputation might be damaged especially if a firm collapses. Moreover, they might get prosecuted by investors in carelessness cases. Auditors find themselves depending on the regulatory framework to defend their procedures when it comes to deter creative accounting. Therefore, it is very important for every country to have effective accounting rules and regulations that auditors can depend on. Another inherent problem for auditors is whether or not they possess adequate independence from clients. However, auditors are typically assigned on the grounds of management recommendations despite the theoretical notion that they are appointed by shareholders. Also, they report on management who, in practice, pay for them. In the 1990s, audit firms’ revenues became a mix of audit and non-audit services. Literature shows that since that time a large proportion of audit firms’ fees originates from non-audit rather than audit services, and as a consequence, accounting firms have paid less attention to auditing services. Arthur Anderson received more income for non-audit than audit from Enron (Jones, 2011).

3.7.3 Regulators

Regulators[33] believe that creative accounting may distort accounting information and that "bad accounting" will expel "good accounting" so they strongly trying to control creative accounting (Jones, 2011). Therefore, they are concerned with "constraining this behaviour" (Achilles et al., 2013). Financial crises appear to happen on a regular basis and results in new rules and regulations that are intended to preclude or reduce the likelihood and severity of such crises. Creative accounting could threaten accounting information value and eventually result in more rules and regulations; for example, after the well-known collapse of Enron in 2002 the US regulators passed the Sarbanes-Oxley Act in an attempt to diminish accounting abuses. Consequently, regulators and those who practice creative accounting are involved in an endless battle. One obstacle for regulators is that the flexibility within GAAP that is essential for presenting a true and fair view of a company's transactions is the same tool that creative accountants use to produce a creative view of a company's transactions (Jones, 2011). Moreover, regulators, as a group that are affected by the earnings management decisions, have a dual role in this context. On one side they use the accounting information for decision making (e.g. the tax authority). On the other side, they set the rules and regulations by which accounting information is prepared (Ronen and Yaari, 2008).

3.7.4 Investors

Investors can be divided into two categories; existing shareholders and potential shareholders, these two groups may have different reactions to earnings management

[33] Regulators are those who set the accounting rules and regulations, for example, standards setters and legislators. It could include, as in the banking industry, the Central banks that govern and control commercial banks and the tax authority (government directory) who set the income tax law which may affect the accounting choices, as well as companies law.

decisions (Stolowy and Breton, 2004). For instance, increasing current profit can be seen as a positive mechanism by a current shareholder as it helps to maximise the firm's value in the short run, but on the other side, it could be seen negatively by potential shareholders in the long run. Current shareholders may view creative accounting as either a "blessing or a curse" depending on what happened later and whether they return their holdings. If company stays in business, shareholders may be wining in the short run, but in the case of failure, shareholders could lose their money (Jones, 2011).

3.8 Earning Management and Ethics

Recent accounting scandals have raised the issue of earnings management ethics. Although earnings management could arguably be performed in a legal and lawful way, it remains an ethical issue in the financial reporting context (Abdelghany, 2005).

Geiger and Smith (2010) argue that not all earnings management practices lead to inappropriate financial reporting, therefore, it is important to investigate the acceptability of earnings management from different perspectives, they added that:

> "… the evaluation of perceptions regarding earnings management behavior is a vital concern for business reporting worldwide. To the extent that perceptions lead to the practice of earnings management, an examination of these perceptions is particularly germane to the evaluation of the financial reporting climate in our growing international business community, and is of direct concern regarding the comparability of reported financial information across countries. Accordingly, it is critically important to examine the perceptions of individuals from different countries in an attempt to evaluate the climate for earnings management that may exist" (Geiger and Smith, 2010, p. 21).

Elias (2004) has concluded that despite the belief that earnings management practices are widespread however there is no agreement within the accounting profession regarding its ethical acceptability. In the same vein, Abdelghany (2005) suggests that although earnings management behaviour "does not explicitly violate accounting rules, it is an ethically questionable practice" (p. 1002).

The literature documents considerable research on the acceptability or otherwise of earnings management practices to different stakeholders. The following section discusses what is meant by ethics in general and what it means particularly in the business context. Then, related literature that focuses on the ethics of earnings management activities will be addressed.

3.8.1 Business Ethics

Business ethics has become an important issue in the current business world and is attracting a great deal of attention from the business community as well as researchers (Rashid and Ibrahim, 2008). Atakan et al. (2008) suggest that it becomes so essential to focus on the ethical values and perceptions of the involved parties due to the ethical violations that have arisen recently. They have also noticed that business practitioners have been frequently faced with ethical matters in their work place. Tseng et al. (2009) pointed out that in order for a business to be ethical it "requires that the organization or individual behaves in accordance with the carefully thought-out rules of moral philosophy" (p. 587). Valentine and Fleischman (2008) emphasized that attention to ethics as well as corporate social responsibility is a vital issue in light of the fact that business values are declining due to recent scandals. It has also been confirmed that the corporate scandals that recently took place have indicated that unethical and immoral practices that have been conducted by business organizations may impose substantial consequences for their stakeholders (Cacioppe et al. 2008). For instance, Enron and Arthur Andersen created chaos in the business world when their unethical practices became reported in the media (Rashid and Ibrahim, 2008). In the wake of the Arthur Andersen collapse, accountants became aware that the unethical behaviour of some individuals may have an adverse consequence for the entire profession. The accounting profession has to be able to maintain the perception of high ethical standards in order for it to be able to accomplish its fundamental function which is providing accounting information users with reliable accounting information. As capital markets’ efficiency is contingent on accounting information users' confidence in this information is vital. Moreover, agency theory also suggests that the auditor's ethical behaviour is crucial in the process of financial reporting (Felton et al., 2008). According to Priest (2002, cited in Elias, 2004) failure of corporate ethics can be attributed to unethical earnings management. Elias (2004) suggests that recent organization collapses have powered the ethical argument toward the earnings management behaviour. Any organization that is operating within a society is considered to be a social organization as long as it serves this society and is rewarded for its services, Preston (2001, cited in Yong, 2008) suggested that a business has an obligation “to contribute towards society as part of its social responsibility” as long as it operates in and benefits from this society. De George (1990) considers business as a social enterprise and that its mandate and limits have been set by society; although business's limits are usually moral, they normally take the form of written law.

According to De George (1990) ethics can be defined as:

> "A systematic attempt to make sense of our individual and social moral experience, in such a way as to determine the rules that ought to govern human conduct, the values worth pursuing, and the character traits deserving development in life. Ethics concerns itself with human conduct, taken here to mean human activity that is done knowingly and, to a large extent, willingly" (De George, 1990, p. 14).

Rushton (2002, cited in Lopez-Gamero et al. 2008) defined ethics as “the application of moral principles in making choices between right and wrong courses of action” he added “business ethics is the application of those moral principles in making business decisions”. (p. 701).

The Online Oxford Dictionary offers a number of definitions for ethics, one of which is "the branch of knowledge that deals with moral principles”. Morality, according to De George (1990) refers to:

> "…practices and activities that are considered importantly right and wrong; the rules that govern those activities; and the values that are embedded, fostered, pursued by those activities and practices" (De George, 1990).

Fisher and Lovell (2003) in distinguishing between ethics and morality consider ethics as about doing good and that it deals with the good life for humanity, while morality is considered as not doing harm and it is a concern for justice. Based on categories of bad, good, legal and illegal, they set forth four combinations to judge the rightness of actions that are; (a) actions that are good and legal but not a legal obligation; (b) actions that are wrong and illegal; (c) actions that legal but bad; and finally, (d) actions that are good but illegal. Earnings management (in the UK interpretation of the term as discussed above) as a practice obviously lies under section (c), earnings management is legal but it has bad consequences for some stakeholders.

According to Geiger et al. (2006) an ethical issue in the context of financial reporting takes place in almost every month and they added that, evaluating the ethical behaviour in the financial reporting field is a critical issue in business practice.

Earnings management has been regarded as one of the controversial and significant areas in the accounting literature and might be "the most important ethical issue facing the accounting profession "(Merchant and Rockness, 1994, p. 92). As stated earlier in this chapter earnings management is considered to be wide spread and according to Geiger et al. (2006) every accountant and every corporation has faced management temptation to manage the reported earnings. Companies can face continuous pressure to produce a steady growth of earnings which can eventually result in forceful managers being tempted to intervene in the financial reporting process. Furthermore, the practice of earnings management which arguably seeks to mask the true financial position of a company, in addition hides significant information that investors need to know (Loomis, 1999, cited in Elias, 2004) Levitt (1998, p. 16) considers earnings management as “accounting hocus-pocus where financial reality is hidden from investors”.

Several studies have been conducted to examine the perceptions of different stakeholders regarding the ethical acceptability of earnings management practices. According to Giacomino et al. (2006) little attention was paid to the morality of earnings management until the work of Bruns and Merchant that was published in an issue of Management Accounting in 1990. In their study Bruns and Merchant (1990) surveyed the readers of the Harvard Business Review asking for their perceptions about the acceptability of earnings management practices through a questionnaire consisted of 13 earnings management situations that the authors had observed either directly or indirectly. Since that time, research has been conducted using the same questionnaire in order to investigate the perceptions of the ethics of earnings management.

Bruns and Merchant (1990) surveyed a total of 649 managers. That questionnaire contained 13 earnings management situations which the authors had observed either directly or indirectly, these situations were all legal and consistent with GAAP with minor ones that not consistent with GAAP. All situations involved earning management actions. Bruns and Merchant described their results as "scary" and noticed that if a practice is not clearly banned or deviated slightly from the rules it is considered as ethical irrespective of who is affected by the practice or "the information that flows from it".

Merchant and Rockness (1994) have carried out research to assess the perceived morality of earnings management practices in a sample of general managers, staff managers, operating-unit controllers and internal auditors using a modified version of the questionnaire of 13 earnings management activities that was used by Bruns and Merchant (1990). Their results reveal that accounting manipulations were judged more "harshly" than operating manipulation regardless of whether accounting manipulations were consistent with GAAP or not. Also the direction of earnings management practice (i.e. increase or decrease in reported profit) was not important as respondents showed no significant difference between the two directions. In addition, results showed that larger earnings management actions were rated as being significantly less acceptable than smaller actions. The period of effect was also found to matter; respondents rated year-end actions as significantly less acceptable than quarter-end actions. Another study which examined how financial statements users' judge the ethics of earnings management actions was conducted by Kaplan (2001) who considered his research as an extension of that of Merchant and Rockness (1994). The latter ascertained the views of various organizational members, while the former consulted those outside the organization because "managers, companies, and policy makers" should be concerned about how external parties perceive the ethics of earnings management activities. Therefore, the sample consisted of Master in Business Administration (MBA) students taking evening classes, (evening MBA students, according to Kaplan, are older and have large work experience in comparison to day MBA students). The study involved an experiment in which participants were given three scenarios describing earnings management by a general manager of a large division in different publicly owned corporations. The scenarios were developed and adopted from Bruns and Merchant (1990). The participants were randomly allocated into one of two user classes being shareholders and non-shareholders; also participants were randomly assigned to two subgroups depending upon the explanation supplied above the intent behind the earnings management; these were based on individual benefit and company benefit. The results showed that shareholders assess earnings management as being less unethical when it was intended for company benefit but that intent did not affect the ethical assessment of non-shareholders. Similarly, Clikeman et al. (2001) examined the perceptions of accounting students from the US and five Asian countries using the method developed by Bruns and Merchant (1990) and they found that students object most strongly to earnings management activity that involves accounting manipulation and increased reported income. Also their findings showed that students were less critical of earnings management when the manipulation was small or was committed in order to help the company to survive.

Elias (2002) tested the relationship between personal moral philosophies (i.e. idealism and relativism), ethics as well as social responsibility, and the ethical judgment of earnings management practices. His sample consisted of accountants in public practice and industry, accounting faculty and students. The questionnaire of Merchant (1989) was adopted in this study. The results showed that all respondents viewed operating earnings management as a questionable practice at worst, while accounting manipulations were viewed as “slight to serious” ethical breaches. The results revealed a positive relationship between an individual’s idealism and his/her perception of earnings management ethics, and a negative relationship between relativism and the ethical perception of earnings management.

In another study, Elias (2004) investigated the relationship between corporate ethical values and earnings management, using a sample of Certified Public Accountants (CPAs) in public accounting, industry and academia to test whether accountants who are employed in different organizations (possibly with different ethical values) will perceive earnings management practices differently. The Bruns and Merchant questionnaire was used to determine the perceptions of respondents. His results showed a positive relationship between perceptions of corporate ethical values and perceptions of earnings management though accountants employed in high (low) ethical values organizations perceived earnings management practices as unethical (ethical). Also the results revealed that “CPAs in industry were significantly less likely than those in public accounting and academia to perceive high ethical values in their organizations” (p. 92).

Al-Hayale and Lan (2005) examined the attitudes of managers and external auditors regarding the ethical acceptability of earnings management. To determine the acceptability of earnings management practices by both managers and external auditors, a questionnaire survey was employed; this questionnaire was partially based on the instrument of Bruns and Merchant (1990). Their results highlighted that auditors perceived earnings management practices to be less ethical than managers. No difference was found between male and female auditors towards the ethics of earnings management actions.

Geiger et al. (2006) investigated the influence of national culture on perceptions about the acceptability of earnings management within eight countries; they drew on Hofstede's work (1980, 1991, and 2001) where he classified cultural dimensions into: (a) individualism/ collectivism, (b) power distance, (c) masculinity/ femininity, and (d) uncertainty avoidance. They also drew on the questionnaire of Bruns and Merchant (1990). Their results suggested that middle individualism countries perceived earning management as being more unacceptable than low and high individualism countries. Individuals from high power distance countries viewed operational earnings management less favourably than those from low power distance cultures. Individuals from high masculinity countries perceived earnings management less favourably than low masculinity cultures and there was no relationship between the last cultural factor and earnings management activities as results did not find any support for either a positive or a negative relationship between uncertainty and individuals' perceptions of earnings management techniques.

Giacomino et al. (2006) undertook a comparison study. They examined the perceptions of undergraduate business students and business managers about the ethics of specific earnings management practices and compared their results with those of Bruns and Merchant (1990) to check if there were any differences after 15 years. They used the questionnaire of Bruns and Merchant (1990) as their research instrument. Their results suggested that females judged earnings management actions as being less ethical than males; undergraduate students had a stricter position toward earnings management activities than business managers, and accounting majors tended to perceive earnings management practices less favourably than other majors.

The ethics of earnings management have been also examined from the view point of students and professionals by Grasso et al. (2009). They investigated the perceptions of students and professionals after the passage of the Sarbanes-Oxley Act of 2002 (SOX). They found out that both students and professionals perceived earnings management as being more questionable and less ethical when comparing the year after to the year before SOX. Their findings also revealed that the perceived ethics of earnings management has been affected by the accounting scandals which had occurred.

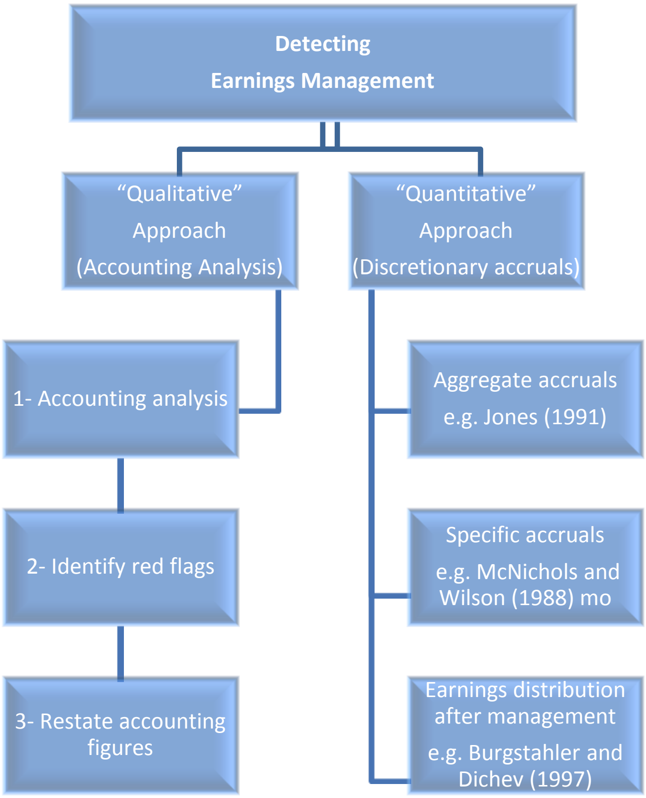
Jooste (2013) conducted a survey to examine the perceptions of students and business managers about the morality of earnings management. The survey objective was to determine if there was any difference between students' and business managers' views of the ethics of earnings management. Her survey instrument was the same questionnaire that was used in the Giacomino et al. (2006) who benefited from the questionnaire of Bruns and Merchant (1990). The results suggested a conflict of view between students and business managers; students tended to judge the practices more ethical than business managers. Also the results showed that earnings management tended to be judged differently by male and female. Males tended to view earnings management practices less favourably than females.

Johnson et al. (2012) investigated the earnings management perceptions of managers using a different method from that mentioned above. In their study they investigated the managers' perceptions in an experimental setting, based on descriptions of some actual events within a company. They developed a scenario of four earnings management practices. Their findings suggested that managers would engage in earnings management when the consequences for the company were favourable.

3.9 Detecting Earnings Management Practices

A clearer understanding of earnings management requires knowledge on how to detect it. Mohanram (2003) identified two approaches that can be followed to identify the existence of earnings management practices; a qualitative approach and a quantitative approach. The first approach requires a detailed analysis of a firm's accounting policies whereas the second approach focuses on an analysis of accruals (Mohanram, 2003). It could be inferred that the first approach is more likely to be applied by a single user of financial statements, for example, an auditor or investor. For instance, during the audit process, the auditor has the ability, being an expert with full access to the accounting records, to spot indications that might exist as a consequence of earnings management practices. Thus, this approach could be called a pragmatic approach for detecting earnings management. On the other hand, the quantitative approach for detecting earnings management deals mainly with identifying discretionary accruals on an aggregate basis, and uses statistical based techniques on large samples to test for the existence of earnings management. Furthermore, this approach has been adopted by academics so it could be called the academic approach. Figure 3.3 below illustrates components of the two approaches.

Figure 3.3: The Earnings Management Detecting Approaches



3.9.1 Qualitative Approach (Financial Statements Analysis)

Adopting this approach to detect earnings management practices requires a clear understanding of the firm's accounting policies (Mohanram, 2003). This approach was adopted by Mohanram (2003) as a mechanism by which earnings management could be tested[34]. He has provided a framework[35] to carry out accounting analysis in order to detect earnings management.

The steps of the Qualitative Approach adopted by Mohanram (2003) are articulated in Figure 3.3 and can summarised in three basic stages; accounting analysis, identifying red flags, and restating accounting numbers.

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[34] To date the author is unaware of any other research which uses this approach.

[35] This framework, according to Mohanram (2003) is based on the Accounting Analysis chapter of "Business Analysis and Valuation" by Palepu et al. (2000).

First of all an accounting analysis has to be carried out. The first step in this stage is to identify the key accounting policies of the firm so that items that are most likely to be manipulated become evident and thereby receive adequate scrutiny. In the banking sector, for example, one of the key policies might be the loan loss provision (Palepu et al., 2000). The second step in the first stage is to assess the accounting flexibility a manager is offered. The more flexibility a manager has the more likely it is that earnings management occurs. Step number three is to evaluate the accounting strategy of the firm and compare it with industry norms. The fourth step is the assessment of the disclosure quality; despite the fact that accounting rules require a certain level of disclosure as a minimum requirement, managers still have a considerable choice in this regard. Given this considerable choice, managers can ease the analyst's assessment of the firm by providing adequate disclosure given that disclosure quality is an important factor in assessing accounting quality. Disclosure quality is a vital aspect of an accounting system that can assist in the assessment of overall accounting quality (Palepu et al., 2000).

The second stage of the qualitative approach is to identify the red flags that may indicate that earnings management has occurred. Palepu et al. (2000) provide potential red flags that should be considered during the qualitative approach to detecting earnings management practices. These potential red flags are presented in Table 3.1.

Table 3.1: Red Flags Indicating Potential Earnings Management

Unexplained changes in accounting in the case of poor performance.
Unexplained transactions resulted in increasing profits.
Accounts receivable that are not correlated with revenues.
Increases in inventories that are not in relation to sales increases.
A gap between reported income and cash.
A gap between reported income and tax income.
The use of financing mechanisms like research and development partnerships and the sale of receivables with recourse.
Unexplained large asset write-offs.
Large year-end adjustments.
Qualified audit opinions or unjustified change in external auditor.
Related-party transactions or transactions between related entities.

Adaptation from: Palepu et al. (2000).

The list of red flags may also include "allowances for uncollectible accounts that are not correlated with receivables, reserves that are not correlated with balance sheet items, questionable acquisition reserves, [and] earnings that consistently and precisely meet analysts' expectations" (Magrath and Weld, 2002, p. 53). Finally, once the first two stages are performed and earnings management has been confirmed to appear very likely, the final stage for the analyst is to restate the financial statements figures to eliminate the effects of earnings management and so lessen the misrepresentation in the financial statements (Palepu et al., 2000).

3.9.2 Quantitative Approach (Discretionary Accruals Identifying)

The second approach to test for earnings management is the quantitative approach that is mainly based on identifying discretionary accruals. Accruals can be measured as the difference between net income and cash from operations (Yang et al., 2012). Basically, most earnings management activities are based on accruals because most accounting decisions involve some accruals. For example selling on credit requires the creation of an accrual since the sale is recognized in the income statement accompanied by an accounts receivable which is accused in the balance sheet because no cash is received; once the cash is received the accounts receivable will be reversed. Also, accruals are used as a basic principle[36], i.e. this matching is done in order to obtain a better measure of period economic performance than cash flows (Mohanram, 2003). In the same context, Sun and Rath (2010) suggest:

> "Fundamentally, more management discretions are often made through accruals. More accruals are in place simply because the accounting system creates accruals in order to recognize revenues when they are earned and match expenses to those revenues, irrespective of whether cash has been received or paid. This matching principle makes accounting earnings a better economic measure of firm performance than cash flows" (p. 128).

Accruals can be divided into two components; discretionary and nondiscretionary. Discretionary accruals are recognised as abnormal or managed accruals and are always

[36] IAS 1 requires the accrual basis for financial reporting purposes.

connected to earnings manipulation. On the other hand, nondiscretionary accruals are recognised as normal or unmanaged accruals. (Kang and Sivaramakrishnan, 1995; Peasnell et al. 2000). Moreover, accrual accounting as a means to manage earnings seems to be the preferred option for management as accruals are difficult to observe compared to earnings management practiced through real transactions[37]. In this context, Young (1999) suggests that:

> "From a managerial perspective, accruals are likely to represent a favoured instrument for manipulating reported numbers because of their relative low cost and opaque nature" (p. 833).

Sun and Rath (2010) suggest that it is easy for researchers to test for managing earnings through accounting choices for the following reasons:

> "First, the choices of accounting policies can have a material impact on reported earnings and consequently are unlikely to be adopted without management consideration of the effects. Second, the choices or changes of accounting policies provide a measure that is purely discretionary. No assumption needs to be made concerning the magnitude of the discretionary component of an accounting choice/change. This makes the detection of earnings management relatively easier" (p. 123).

On the other hand, it might be difficult to test for earnings management through real transactions due to the lack of a measurement. In this regard, Sun and Rath (2010) indicate:

> "Nevertheless, researchers found it is difficult to detect earnings management through real actions, because there is no benchmark to determine the right actions that managers have taken" (p. 123).

Given the flexibility offered by GAAP, managers could manage earnings by choosing from alternative accounting methods within GAAP or by applying these methods in particular ways e.g. changing estimates of assets' lives. The former may be noticeable and thereby be spotted by the auditor. However, the latter could be a bit harder for an auditor to observe (at least in terms of motives) (Schipper, 1989). In this regard, Dechow (1994, cited in Sun and Rath, 2010) blames the flexibility offered by GAAP for giving the opportunity to

[37] Although some scholars argue that the real earnings management is the preferred means of earnings management by managers (for example, Graham et. al., 2005), a study by Zang (2012) reveals that managers trade off the two earnings management types (real and accounting) according to their relative costs. The discussion of which is preferred by managers is beyond the scope of this study.

managers for earnings management, "[d]ue to this flexibility, discretionary accruals are the component that often gives managers opportunities to manipulate earnings" (p. 124).

Young (1999) considered testing for earnings management as a central issue in financial statement analysis. He added that managers are provided with a series of earnings management techniques that range from real operating decisions such as asset sales and changes in R&D expenses to financial reporting decisions such as accounting method changes and accrual choices. The latter, accruals choices, according to Young (1999):

> "Represent a less costly mechanism by which managers can affect reported numbers than, for example, changes in R&D expenditure or asset disposals. Further, because they are often difficult to observe directly, the effect of accrual decisions are more difficult for external parties to adjust for ex-post, compared with the effect of asset sales and changes in accounting methods. A disadvantage of using the accrual mechanism to manipulate reported numbers is that under- (over-)statements made in the current period must reverse in the future" (p. 858).

Empirical studies for testing earnings management mainly focused on the discretionary part of accruals by testing the discretionary components of reported earnings (Dechow et al., 1995). According to McNichols (2000), one of the fundamental issues of earnings management testing is measuring management's discretion in reported earnings. In this regard, Stolowy and Breton (2004) argue that "[a]s profit differs from cash flow by the total of accruals, manipulation of the profit figure implies manipulation of the accruals" (p. 22). They also added that distinguishing between normal and abnormal accruals represents a challenge that researchers face (Stolowy and Breton, 2004). Separating out the discretionary and non-discretionary elements of accruals has been described by Mohanram (2003) as a "critical aspect".

In the quantitative approach for earnings management detection, McNichols (2000) provided an overview on three techniques by which earnings management can be tested based on discretionary accruals. These techniques are summarised in Table 3.2 and are briefly discussed in the next section.

3.9.2.1 Aggregate Accruals

The first technique under the quantitative approach examines aggregate accruals by using regression models to compute both expected and unexpected accruals. Dechow et al. (1995) suggest that total accruals be used as a "starting point" to measure discretionary accruals. According to this method, a model is used to separate total accruals into discretionary and nondiscretionary components. This technique endeavours to recognize discretionary accruals based on the relation between total accruals and hypothesised descriptive factors. In this context, Sun and Rath (2010) argue:

> "Accruals, relative to other methods, are preferred in detecting earnings management. Nevertheless, the major challenge for researchers using accruals to detect earnings management is the ability of the model correctly separate accruals into discretionary and non-discretionary accruals" (p. 130).

One of the most used examples of accrual-based models is the Jones' (1991) model. Beneish (2001) suggests that Jones (1991) model is based on the notion that accruals are normally influenced by manager's discretion and change with economic conditions. To measure for earnings management Jones (1991) used the discretionary component of total accruals. She proposed a regression to control for nondiscretionary factors that affect accruals, by postulating a "linear relation between total accruals and changes in sales and property, plant and equipment" (McNichols, 2000). Beneish (2001) describes the relationships included in Jones model as "This model relates total accruals to the change in sales and the level of gross property, plant and equipment" (p. 6). He also added that the model is based on two assumptions; the first, that current accruals resulting from a firm's economic situation are related to sales changes, or sales growth. The second, that "gross property plant and equipment controls for the portion of total accruals related to nondiscretionary depreciation expense" (p. 6).

3.9.2.2 Specific Accruals

Alternatively, a specific accruals model could be used to test for earnings management; this technique is typically adopted for a specific industry where a particular accrual is significant and represents a substantial portion of the total assets (Sun and Rath, 2010). Testing earnings management by this technique, according to McNichols (2000), is based on the knowledge of nondiscretionary and discretionary behaviour of accruals in such an industry. As the researcher can benefit from his/her knowledge of GAAP "the researcher can develop intuition for the key factors that influence the behaviour of the accrual, exploiting his or her knowledge of generally accepted accounting principles" (p. 333). The banking industry is given as an example where such a technique is applicable and the loan loss provision (LLP) represents a large accrual that bank managers could use to manipulate earnings. Literature suggests that bank managers use LLP as a tool for earnings manipulation (Sun and Rath, 2010).

McNichols and Wilson (1988) suggest the provision for bad debts in the banking industry as a mechanism for accrual-based earning management. A specific accrual technique, according to McNichols (2000), is applicable in such industries where business practices can lead to accruals being in question due to their materiality and their likelihood of being the object of judgment and discretion. Applying this technique requires knowledge of which accrual is likely to be manipulated. McNichols (2000) argues that "[i]f it is not clear which accrual management might use to manipulate earnings, then the power of a specific accrual test for earnings management is reduced" (p. 333). She also pointed out that using the specific accrual technique could be costly as "specific accruals approaches generally require more institutional knowledge and data than aggregate accruals approaches" (p. 333). Another disadvantage of the specific accrual technique could be the lack of "generalizability of the findings" as she claimed that "the number of firms for which a specific accrual is managed may be small relative to the number of firms with aggregate accruals" (p. 333).

3.9.2.3 Earnings Distribution after Earnings Management

The last technique for earnings management detection is based on the distribution of earnings after they have been managed. The distribution technique, according to Sun and Rath (2010, p. 126), is "relatively new in the literature" and according to McNichols (2000) was developed by Brughstahler and Dichev (1997). This technique, according to Holland and Ramsay (2003), implies that managers are motivated to manage earnings in order to meet "certain earnings benchmarks or thresholds such as reporting positive profits, or sustaining recent profit performance" (p.42).

The study of Burgstahler and Dichev (1997) investigated the stream of earnings distribution after being managed and they revealed that managers prefer to report positive earnings (profits) and that earnings are relatively close to the prior period's figure. In their words, "firms manage reported earnings to avoid earnings decreases and losses" (p. 99). This approach has been described by Beneish (2001) as an "interesting alternative methodology" and he reported on their work by saying:

> "They investigate discontinuing in the distribution of reported earnings around three thresholds: (1) zero earnings, (2) last year's earnings, (3) this year's analysts' expectations. They make predictions about the behaviour of earnings in narrow intervals around these thresholds. The evidence appears consistent with predicted discontinuities: there tend to be less (more) observations than expected for earnings amounts just below distributions is informative about which firms are likely to have managed earnings" (p. 7).

This technique has been criticised by Beneish (2001) for being "silent about the form and extent of earnings management" (p. 7).

3.9.3 Alternative Approach (Questionnaire Survey)

In addition to the above approaches to identifying earnings management, a third approach could be followed to test for earnings management. Researchers may resort to survey opinions of some related parties to assess their perceptions of whether earnings are being managed.

The literature shows that some researchers have carried out surveys to elicit professionals' perceptions on earnings management. These include Baralexis (2004), who claims that adopting this approach enables researchers to conclude real "not hypothesized" motives behind such activity. Nelson et al. (2002) used a field-based questionnaire to elicit auditors' recollections of specific managers' attempts to manage earnings. They claimed that this approach provides transaction-level data on earnings management attempts and their consequences on auditors' decisions. The accuracy of recollections is important, but cannot always be relied up on in field-based questionnaire. However, techniques have been developed to tackle the fallibility of human memory e.g. eliciting simple facts concerning recent events rather than asking leading questions or eliciting details of old events. Also, accurate recall could be encouraged by emphasizing the importance of the research and affirming the anonymity of responses (Nelson et al. 2002).

Baralexis (2004) based his study on a questionnaire to survey 100 experienced auditors and 100 experienced accountants. The questionnaire was designed with close reference to the relevant literature and consisted of eight questions exploring creative accounting in Greece.

Similar to Baralexis's work, Noronha et al. (2008) explored earnings management in China. They surveyed 11 accrual-earnings management techniques that might be used by Chinese companies. The questionnaire was distributed to 1400 companies. Their results indicated that earnings management is pervasive in China and that managers consider earnings management as reasonable and useful. Noronha et al. (2008) concluded that the prime incentive for earnings management in China is management promotion and compensation which is inconsistent with prior literature that suggests that capital market pressure is the most important motivation for earnings management.

Another study which followed this approach was by Al-khabash and Al-Thuneibat (2009). Their study aimed at providing evidence on earnings management existence from the perspective of external and internal auditors in Jordan. A specially designed questionnaire was used. Their sample consisted of 61 internal auditors and 66 external auditors. The results were summarized as suggesting that external auditors believe that managers are involved in earnings management to increase and decrease income while internal auditors believe that managers are involved in earnings management to only increase income.

3.10 Earnings Management in the Banking Industry

Bank managers are much more concerned about earnings stability and growth; therefore it is anticipated that bank managers are engaged in earnings management (Bhat, 1996). Banks generally represent a significant proportion of total listed companies which means that banks have an influential role in the capital market (Kanagaretnam et al. 2010). Shen and Chih (2005) stressed the importance of banks and describe the banks' share in the capital market as "typically large". Moreover, banks play a vital role in economic development, with investors and regulators monitoring banks' performance on a regular basis; the former for monitoring share prices, the latter to assure the robustness of a banking system's financial soundness. As a result, reported earnings growth remains one of the key pointers that demonstrate a bank's performance and financial stability which ultimately suggests that bank managers may be inclined to smooth earnings volatility over periods. By earnings management in general and income smoothing in particular, bank managers can help to sustain the appearance of a robust financial position as well as meeting legal requirements (Taktak et al., 2010a). It has been suggested that income smoothing is a continuing practice that is employed by banks (Bhat, 1996). Moreover bank managers are accused of being more likely to indulge in earnings manipulations compared to others (Leventis, 2011).

For instance, Bhat (1996) suggests that banks' managers exercise income smoothing for a number of reasons: (a) to enhance the risk perceptions of the bank to its investors and regulators; (b) to support managers' efforts in maintaining their compensation schemes; (c) to satisfy shareholders where income smoothing will enable managers to afford a constant stream of dividends; and (d) to provide low quality managers with a good chance of delivering an image of high quality management to investors where measuring management's quality is difficult. Also, banks' managers may smooth earnings to reduce tax payments and improve share prices.

The literature reports that banks' managers use the LLP as a mechanism for earnings manipulation (Anandarajan et al. 2003, 2007; Kanagaretnam, 2010; Leventis et al. 2011; DeBoskey and Jiang, 2012). GAAP offers latitude in choices available to account for a specific set of financial events which gives the opportunity to smooth income through choosing from accounting alternatives. Given the considerable scope for banks' managers when estimating the amount of LLP, banks' managers may smooth earnings by manipulating LLP (Bhat, 1996; Kanagaretnam et al., 2003). LLPs are designed to reflect the sum of funds that are likely to be lost in the future (Bhat, 1996). LLPs reveal the expected future loan losses to be disclosed in the current period as accrued expenses on the income statement (Whalen, 1994). However, "federal banks and securities regulators" realize that the LLPs that have been anticipated by bank managers cannot precisely match real losses and thus include a margin for inaccuracy, a margin that has been exploited by bank managers (Anandarajan et al. 2007). According to Whalen (1994), bank managers possess private information about the default risk inherent in LLPs and as a result their judgement in estimating LLPs each period is essential. He added that investors and regulators cannot obtain all of bank managers' information as it is "prohibitively costly" and accordingly "bank managers can exercise discretion over the timing of provisions for certain loan losses".

Shen and Chih (2005) list three factors that demonstrate the importance of studying earnings management in the banking industry. First, banks at all times fear a potential problem of illiquidity that puts them under the risk of extensive bank runs. Therefore, with the intention of retaining depositors' confidence, banks resort to earnings management practices in order to avoid negative earnings.

Second, they cite Morgan (2002) who says that: "… uncertainty over the banks stems from their assets, loans and trading assets in particular, the risks of which are hard to observe or easy to change. Banks' high leverage compounds the uncertainty over their assets; their assets present bankers with ample opportunities' for risk or asset substitution, and their high leverage inclines them to do so." Therefore, bank managers have a high incentive to manage earnings to hide asset substitution behaviour.

Third, banks are highly regulated organizations in which a non-performing loan ratio, among other things (i.e. capital adequacy ratio, liquidity ratio, etc.) is firmly regulated. Therefore, earnings management could be adopted in order to avoid regulations' breach.

According to Kanagaretnam et al. (2010) a bank's LLP is the proper approach to study earnings management in the banking sector for two reasons. First, given the considerable discretion that is allowed by GAAP, bank managers may use this flexibility in using LLP for earnings management. Second, LLPs are considered to be major accrual items in banks accounts that provide bank managers with sufficient leeway in manipulating earnings.

3.11 Empirical Research on Using LLPs to Manage Earnings

The literature shows a great deal of research on earnings management practices. However, only little is related to the banking industry (Taktak et al. 2010b). According to Peasnell et al. (2000, p. 318), financial institutions may be excluded due to the difference in the financial reporting system between financial firms and industrial firms. Also, financial firms have a "fundamentally different accrual process" relative to other industries.

According to Burgstahler and Dichev (1997, cited in Shen and Chih, 2005) conflicting incentives may exist within regulated firms in general to report lower earnings or decreases in earnings whenever economic benefits from reporting lower earnings to regulators take place. More particularly, in the financial institutions category which includes the banking industry, there may be a negative relationship between avoiding earnings decreases and the extent of regulatory oversight. Much research on financial institutions is carried out in the USA and Europe and has come to a conclusion that LLPs are widely used for, amongst other things, earnings management (Anandarajan et al. 2003, 2007; Leventis et al., 2011).

Researchers have adopted different techniques to test for bank managers' use of LLPs to manage earnings. Some used the specific accrual technique; others have applied the earnings distribution techniques. The next section provides a summary of some studies that examined earnings management or specifically income smoothing as a form of earnings management within the banking industry. It is notable that none of these studies followed the first quantitative technique (total accruals).

Bhat (1996) examined the income smoothing hypothesis for 148 banks that reported their earnings over the period 1981-1991. To examine whether banks smooth their income the researcher regressed logarithms of earnings after taxes and LLP against the year. His results suggest that banks use LLP to manipulate reported earnings.

Another study that followed the specific accrual technique was conducted by Kanagaretnam et al. (2003) who studied the underlying motives of bank managers for income smoothing through LLPs. They provided evidence that bank managers use LLPs for income smoothing as they save earnings through LLPs in good times to borrow them in bad times. Their results suggest that job security and the cost of borrowing motivate bank managers to engage in income smoothing practices; managers faced with job security fears typically use LLPs as an income smoothing device. They claim their findings to be of great interest to regulatory bodies who are interested in banks' financial reporting quality.

Anandarajen et al. (2003; 2007) also followed the same technique to capture earnings management behaviour. For instance, Anandarajen et al. (2007) examine the use of LLPs by Australian banks for earnings management. The data used was from the financial reports of 50 commercial banks, 10 of which are listed banks, for the period of 1991-2001; the total number of observations was 441. Their results show that Australian banks in general use LLPs to manage earnings, and, listed banks are more likely to do so relative to unlisted ones. Their results also suggest that regulators consider the fact that managed reported earnings do not precisely represent the real economic performance when assessing the "overall financial risk".

Agarwal et al. (2007) investigate earnings management practices within Japanese banks and found out that Japanese banks do significantly use LLPs to manage earnings in the period of 1985-1996. Other evidence from Japan is provided by Kwak et al. (2009) who investigated the use of LLPs by Japanese bank managers for the period of 1996-1999 and found out that Japanese bank managers manipulate LLPs to signal financial strength when they need external financing. Both studies employed the specific accrual technique to detect earnings management within Japanese banks.

Taktak et al. (2010a) studied the practice of income smoothing on a sample of 278 commercial banks operating in OECD countries. They offered evidence of artificial and real income smoothing as their results indicate that the majority of the banks do smooth their incomes intentionally by LLPs or by selling trading securities. Their results also indicated that income smoothing is influenced by both banking regulatory and institutional factors.

The specific accrual technique has been also applied to Islamic banks. On a sample of 66 Islamic banks from various Muslim countries, Taktak et al. (2010b) found that Islamic banks extensively smooth their incomes. However, their study provided no evidence on the use of LLPs to smooth income by Islamic banks. They examined whether Islamic banks do smooth their income using LLPs. However, they studied only one form of income smoothing that is, artificial income smoothing through LLPs resulting from Islamic financial products i.e murabaha, musharaka and mudaraba.

Other studies, for example, Shen and Chih (2005) adopted the third quantitative technique that is, earning distribution discontinuities. In their study as to whether earnings management within the banking industry is practiced across 48 countries they found that earnings management certainly was practiced in their sample. They used three measures to test for earnings management based on those of Burgstahler and Dichev (1997), Degeorge et al. (1999), and Leuzet al. (2003). They tested whether banks manage their earnings so as to surpass thresholds, such zero earnings and zero earnings changes.

Leventis et al. (2011) examined the impact of IFRS implementation on the use of LLPs to manage earnings within 91 EU listed commercial banks operating in 18 European countries. They divided their sample into two categories; early adopters and later adopters. Their results reveal that banks do manage their earnings through LLPs but the implementation of IFRS has meaningfully reduced earnings management behaviour.

The earnings management in Islamic banks has been also confirmed by using the earnings distribution approach. Hamdi and Zarai (2012) revealed, that although earnings management practices are not as obvious in Islamic banks compared non-Islamic bank; Islamic banks are engaged in earnings management practices mainly to avoid reporting losses and earnings decreases. Their sample consisted of 125 Islamic banks which offered

1244 bank-year observations. The data related to 27 countries and covered the fiscal years 2000 to 2009.

This thesis adopts the alternative approach by which a questionnaire survey is employed. It also benefits from using interviews to elicit banks stakeholders' perceptions on earnings management. According to the literature, research on detecting earnings management in the banking industry normally implies the use of the specific accrual technique which requires a relative bigger sample of banks than exist in the Libyan Stock Market (LSM)[38].

3.12 Discussion and Summary

Earnings management continues to be a problematic issue in the financial reporting context (Man and Wong, 2013) and an important topic that concerns a wide range of stakeholders including regulators, investors and managers (Achilles et. al., 2013). Its importance, according to Man and Wong (2013), stems from its negative effects on the financial statements as it "may undermine the credibility of financial statements" (p. 400). It involves deliberately management intervention in the financial reporting process to misstate the reported earnings to achieve certain rewards (Foster and Shastri, 2013). This managerial behaviour, according to Aerts et al. (2013) is mainly incurred for "the benefit of insiders" by acting as to "mislead outsiders' perceptions" about the firm's financial performance (p. 94). Although earnings management might be used to make information more informative for outsiders, however it is still questionable. Aerts et al. (2013) argued that:

> "Management's motives for earnings management are, however, not transparent from reported numbers, both manipulative [opportunistic] and communicative [informative] earnings management are likely to feed ex ante uncertainty of users with regard to earnings management consequences" (p. 94).

[38] The total companies that were listed in the LSM as on 10 June 2012 was only 13 of which 7 are commercial banks. The cumulative (total) capital of listed companies is 3 billion LD of which the banks' portion is 2.3 LD billion.

Earnings management may have an adverse consequence on accountability relationships. Accountability, or being accountable, relies on managers providing useful, unbiased, and reliable information to the firm's stakeholders. Aers et al. (2013) stated that earnings management could reveal an accountability breach, they indicated:

> "Given users' ex ante uncertainty with regard to management's earnings management motives, indication of earnings management may be perceived as a significant accountability predicament, and bring management to offer more explanations on performance-related matters in " (p. 95).

This chapter has provided a literature review on the earnings management definition and motivations. The next chapter highlights the theoretical framework adopted for this study: accountability.

Chapter 4

Theoretical Framework

4.1 Introduction

The previous chapter outlined the literature on earnings management and how earnings management could affect financial reporting quality; the chapter also discussed earnings management practices in the banking sector and how such behavior could be seen in terms of business ethics. The purpose of the present chapter is to discuss accountability theory as a potential foundation for exploring the earnings management issue within Libyan Commercial Banks by gathering various stakeholders' perceptions on the research questions being examined.

This chapter is structured as follows. Section 4.2 contains definitions of theory and highlights the importance of theory in social research. Section 4.3 outlines the conceptual frameworks of financial reporting as suggested by Ijiri (1983) and presents a comparison between accountability and decision-usefulness theories. Section 4.4 outlines the accountability framework. Section 4.5 discusses the adoption of accountability as the theoretical perspective for this study and, finally, section 4.6 summarizes this chapter.

4.2 Theory Importance and Definition

The significance of using a theoretical framework in accounting studies has been highlighted by many researchers. For example, Abdel-Khalik and Ajinka (1979, cited in Sihotang, 2003) believed that every single piece of research has to adopt and follow a theoretical framework. Theory, according to May (2011), helps researchers in explaining and understanding the research finding;, it is also considered as "the mark of a mature discipline whose aim is the systematic study of particular phenomena" (p. 27). May (2011) also outlined the association between theory and research by stating, "…for social research to intellectually develop and to be of use in understanding or explaining the social world, we need theory and theory needs research" (pp. 31-32). Theories contain concepts and assumptions whose relationships can be articulated by research; in other words, a theoretical framework specifies whether and how concepts are related and moreover whether a relationship does exist (Neuman, 2004).

The main objective for accounting theory, according to Riahi-Belkaoui (2004) is "to provide a basis for the prediction and explanation of accounting behavior and events" (p. 108). However, accounting theory has developed to prescribe how accounting behavior and events should look. In this context, Watts and Zimmerman (1986, p. 4), indicate that accounting theorists are more concerned about how firms should report about their events. This evolution led accounting theorists to be "normative". Relatively new evidence showing the importance of understanding theory has been related to accounting scandals as pointed out by Deegan and Unerman (2006) who indicated:

> "In the wake of a growing number of high-profile accounting failures (such as Enron and WorldCom), it has never been more important for accountants to thoroughly understand and be able to critique the accounting practices which they use. Without such a theoretically informed understanding, it is difficult to evaluate the suitability of current accounting practices, to develop improved accounting …, and to defend the reputation of accounting where accounting practices are wrongly blamed for causing companies to fail" (p. 4).

They also added that the understanding of accounting theory could have a key role in restoring the "reputation and future of the accounting profession" (p. 5).

Theory has been defined in a number of ways. For instance, it has been described as a "way of seeing and thinking about the world rather than an abstract representation of it" (Alvesson and Deetz, 2000, p. 37). Black (1993, p. 25), on the other hand, defined theory as "explanations of how things function or why events occur". Theory, according to Kerlinger (1986), is a mix of concepts, definitions and propositions that all together can explain and predict behavior. He defined theory as:

> “A set of interrelated constructs (concepts), definitions, and propositions that present a systematic view of phenomena by specifying relations among variables, with the purpose of explaining and predicting the phenomena” (p. 9).

Sekaran (2003) suggests that by ‘theory’, one can justify the relationships between different factors, he defined theory as:

> "A conceptual model of how one theorizes or makes logical sense of the relationships among the several factors that have been identified as important to the problem" (p. 87).

Riahi-Belkaoui (2004) listed four basic functions that a theory performs; description, delimitation, generation and integration. To describe, theory uses research concepts or constructs and their relationships so that a best explanation of the research findings and the forces underlying them are offered. The second function is delimiting which:

> "Consists of selecting the favorite set of events to be explained and assigning a meaning to the formulated abstractions of the descriptive stage. Constraints on or boundaries around speculation and hunches serve that delimiting purpose” (p. 81).

The generation function implies “the ability to generate a testable hypothesis, which is the main objective of a theory or to provide hunches, notions and ideas from which hypotheses could be developed". The last function is integration by which theory would be able to “present a coherent and consistent integration of the various concepts and relations…" (p. 81).

Within the accounting context, accounting theory, according to Hendriksen (1982), plays a significant role in accounting research. It is defined as:

> “Logical reasoning in the form of a set of broad principles that (1) provide a general frame of reference by which accounting practice can be evaluated and (2) guide the development of new practices and procedures” (p. 1).

He added that accounting theory is used to explain and understand current practices, as well as, to offer a “general frame of reference” so that accounting practices can be evaluated and developed.

According to Gray et al. (1996) the theoretical framework chosen by a researcher typically reflects his/her frame of mind. They state that "a theoretical framework adopted in a research project is actually a reflection of the researcher's frame of mind, which is temporary, conditional and debatable" (p. 96).

4.3 Financial Reporting Research Theoretical Frameworks

Despite the ample theories in the academic literature that could be applied in accounting studies, two broad frameworks are commonly adopted. Ijiri (1983) claims that "a conceptual framework of accounting can be decision based or accountability based". Accounting research that is following one of these approaches may not necessarily come to the same conclusion that would have been reached through the other approach (Williams, 1987). In a similar vein, Collison et al. (1993) argue that accountability and decision usefulness are alternatives and may lead to different results. They stated:

> "Any deductive analysis of financial reporting ideally starts with specification of the purpose that financial statements serve. Such specification is problematic, because there appear to be two major alternatives which could generate different analyses and conclusions. These are 'decision usefulness' and 'accountability'." (p. 2).

A notable difference exists between the two mentioned frameworks. The decision based theory is concerned about how useful the accounting information is to users, though focusing on one particular set of accounting information users i.e. investors and creditors. In the words of Williams (1987) it is “ends focused”. On the other hand, the accountability framework seems to be broader to the extent that it recognises a relationship between the preparers of accounting information and the different groups of users as well as society as a whole. Williams (1987) described accountability as “means focused”. Ijiri’s (1983) contrast between the accountability and decision usefulness conceptual frameworks has been summarized by Coy et al., (2001) and is presented in Table 4.1.

Table 4.1: The Distinction between Accountability and Decision Usefulness

	Accountability Conceptual Framework	Decision Usefulness Framework
User versus supplier	Focus is on the relationship between the supplier of accounting information and the user of accounting information (accountor/accountee).	Focus is strictly on the user of accounting information.
Fundamental objective of accounting system	Fairness The qualitative characteristics are technical constraints, which the system must satisfy.	Usefulness The qualitative characteristics are desirable traits, which require trade-offs.
Key qualitative characteristics	Objectivity, verifiability, and stability	Relevance and reliability
Stability	Stability of the accounting system goes beyond consistency and comparability. It means that even if the accounting system is changed, an explicit means of reconciliation from one system to the next is maintained. Otherwise, the interests of one party can be damaged for the benefit of the other.	Consistency and comparability imply a level of stability, but there is no implication that a means of reconciling old and new accounting standards be maintained.
Fairness	In this context, fairness is judged in relation to agreement. Without the agreed upon metric, fairness cannot be determined.	Not explicitly considered. Some mild echoes of fairness in the concept of neutrality or freedom from bias.
Information	More information is not necessarily better. For example, subjective information may be useful to the accountee, but damaging to the accountor.	More information is always preferred to less as long as it is cost effective.
Records or reports	Focus on both the reports and the records, upon which the reports are based.	Focus on the reports.
Motivation of accountor	Takes into explicit consideration the accountor’s desire to present information in the best possible light.	The role of accountor is largely ignored.

Adapted from: Coy et al., (2001, p.5)

Other distinctions between the accountability and decision usefulness frameworks are provided by Gray et al. (1991) who distinguished between the two approaches in many aspects. For example, they noted that accounting information within decision-usefulness is circulated only between management and financial information users[39] while within the accountability framework, the accounting information is potentially the concern of more groups[40]. And, more importantly, accounting information within the decision-usefulness

[39] Accounting information users, according to this theory, are current and potential investors as well as creditors.
[40] Although Gray et al. (1991) indicate that information parties in the accountability framework are the agent and the principal, they indicate that the principal within an accountability relationship should not be viewed

framework is used only for future decisions while within the accountability framework it is used to judge and assess past actions as well as the relationship between accountee and accountor.

Although decision usefulness may be used widely in accounting research, it has been claimed that it ignores notions of justice and fairness as Coy et al. (2001) suggest:

> "The decision usefulness paradigm is based on a context of markets, and assumes resources will be allocated more efficiently when rational economic decisions are facilitated. However, this perspective ignores the simultaneity of efficiency and distribution effects. Value judgments about efficiency are, by necessity, also value judgments about distribution of resources. Consequently, notions of justice and fairness cannot be ignored" (p. 4).

In the next section the accountability concept and relationships will be addressed and then two notions of accountability; narrow and wide notions of accountability will be discussed.

4.4 Accountability Framework

Accountability, according to Bovens (2010), as a term could embrace more than one meaning; depending on the context in which it is used, he indicated:

> "Anyone studying accountability will soon discover that it can mean many different things to many different people" (p. 946).

According to Day and Klein (1987), accountability is expected to be perceived differently in different contexts since it is a social and political process; they believe that accountability is mainly concerned about the definition of a certain type of conduct and how it is assessed. They indicate:

> "Our starting-point is that accountability is all about the construction of an agreed language or currency of discourse about conduct and performance, and the criteria that should be used in assessing them" (p. 2).

Sinclair (1995) stressed the importance of language in shaping accountability understanding. For example, an auditor views accountability as a financial matter, whereas a politician sees accountability as a political issue. He states that:

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as in the agency theory relationship as it could embrace more than one group under the accountability framework.

> "How accountability is defined has changed, underlining the importance of language as agent of ideology in shaping understanding. In theoretical research, accountability has discipline-specific meanings, for example the auditor discusses accountability as if it is a financial or numerical matter, political scientists view accountability as a political imperative and legal scholars a constitutional arrangement, while philosophers treat accountability as a subset of ethics" (Sinclair, 1995, p. 221).

Accountability is arguably something that everyone should respect. Bovens (2007) asserts that accountability is a "gold" concept that everyone agrees with and that it is widely used in political discourse since it implies transparency and trustworthiness. He added that it is also an "elusive concept" that can mean different things to different people. Similarly, Perks (1993) views accountability as something that everyone benefits from; he stated: "Accountability sounds like a good thing –something that we can all be in favour of" (p. 23).

Stewart (1984) differentiated between three types of accountability namely managerial, commercial and public accountability. Managerial accountability exists within an organization where an employee could be accountable for his or her duty to the superior and vice versa. Commercial accountability refers to management accountability to shareholders. Finally there is public accountability which, according to Stewart (1984), includes both managerial and commercial accountability. Under this type of accountability management is accountable to a large range of stakeholders[41]

The focus of this study is to examine and recognise the existing accountability process in the Libyan Commercial Banks focusing on financial accountability. Laughlin (1990) justifies the linkage between finance and accountability based on the importance of finance for an organisation and a particular domain. He also justifies it based on the notion that the way that finance is accounted for will influence how resources and responsibilities are accounted for.

[41] As will be discussed later on this chapter, this type could be referred to as the wide notion of accountability in which an agent is accountable to many groups of accountees.

Accounting, according to Ijiri (1983), is "a business diary", a diary that businessmen keep for the use of others. However, this does not mean that they will not benefit from keeping this record. Managers are required by law to maintain records and provide information to others. This implies an "accountability relationship" between managers and others by which managers are obliged to account for their actions to others. An accountability relationship implies a relation between two parties[42]: the "accountor" who is required to provide accounting information to the "accountee" who receives this accounting information. According to Ijiri (1983) accountability entails certain rights to both accountor and accountee. These rights are governed by accounting which assures that accounting information flows to the accountee in a way which is timely and accurate. On the other hand, the accountor is also protected as accounting requires a certain level of disclosure and determines what financial statements should and should not be disclosed. In other words, under the accountability framework the accountee has the right to know (receive information) and the accountor has the right to "protect privacy" (Ijiri, 1983).

4.4.1 Accountability Concept and Relationships

The accountability concept, according to Laffan (2003), relies on a combination of appropriate structures and procedures in the conduct of public business. In the accounting context, accountability, as a concept, according to Bovens (2007) is connected to accounting and more specifically to bookkeeping and this attached meaning has a historical justification[43].

[42]In between, according to Ijiri (1983), comes the accountant as a third party, this is because the accountant is responsible for preparing the information that flows from the first party to the second. He further claims that an agreement between these three parties is essential under the accountability framework so that a proper information system can be performed. This agreement implies that the accountee needs and wants to possess the information, the accountor is prepared to provide this information, and, finally, the accountant is braced for providing this information in an "objective and verifiable manner" using two basic tools that are records and reports. These two tools are governed by the "conceptual framework of accounting" (Ijiri, 1983).

[43] “Historically and semantically, it is [accountability] closely related to accounting, in its literal sense of bookkeeping. According to Dubnick, the roots of the contemporary concept can be traced to the reign of William I ... required all the property holders in his realm to render a count of what they possessed. … this had evolved into a highly centralised administrative kingship that was ruled through centralised auditing and semi-annual account giving” (Bovens, 2007, p. 448).

Coy et al., (2001), who perceived accountability and stewardship as identical, believe that accountability is an outcome of the separation of ownership from management. They indicate:

> "Accountability, or stewardship, as a modern concept may be traced to the separation of ownership from management in business organisations, and is linked to the notions of stewardship, whereby managers provide an account to owners. The development of joint stock companies and limited liability expanded the need for accountability in the business sector" (p. 7).

The relationship between accounting and accountability is indicated by Gray (1983) as follows:

> "Accountability is a concept which is generally underdeveloped in the accounting literature. As a result it is frequently misused, and commonly taken as synonymous with external financial reporting or financial accounting. Accountability is, however, a very 'rich' concept and its relationship with 'accounting' is rather more complex than is generally recognized in the literature" (p. 4).

Another issue related to the term "accountability" was indicated by Bovens (2007); that is the translation of the term into other languages. He indicates that accountability as a term does not exist in French, Portuguese, Spanish, German, Dutch or Japanese languages and, moreover, they do not distinguish between accountability and responsibility. The Arabic language seems to not have an equivalent word to accountability. The translation of 'responsibility' is commonly used to refer to this term[44].

Bovens (2010) describes accountability as "an icon for good governance"[45]. He points out that it has become a general term that implies "any mechanism that makes powerful institutions responsive to their particular publics" (p. 947).

To Gray (1992) accountability is basically concerned with "the right to receive information and the duty to supply it" (p. 413). In an extended discussion, accountability has been

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[44] Bovens (2010), pointed out that "accountability is used as a synonym for many loosely defined political desiderata, such as good governance, transparency, equity, democracy, efficiency, responsiveness, responsibility, and integrity" (p. 946).

[45] In the USA, accountability is interchangeably used with "good governance or virtuous behaviour" (Bovens, 2007, p. 449).

succinctly defined by Gray et al. (1996) as "the duty to provide an account (by no means necessarily a financial account) or reckoning of those actions for which one is held responsible" (p.38).

Accountability thus implies two "responsibilities or duties". First the accountor is responsible for performing a duty and then is responsible to account for that duty to whom he or she is responsible, the accountee (Gray et al, 1996). However, Cooper and Owen (2007, p. 653) noted a shortfall in the accountability definition given by Gray et al. (1996). The issues of "effective utilization of information" and "associated power differentials" have not been addressed. They suggest for an accountability to be achieved that the accountee (stakeholders) should be given the power to hold the accountor to account. They argue that stakeholder accountability can be enhanced by empowerment.

Another definition given by Gray and Jenkins (1993) holds a similar perspective; they define accountability as "an obligation to present an account of, and answer for, the execution of responsibilities to those who have entrusted those responsibilities" (p.55).

Accountability has been also defined by Bovens (2007) as a:

> "Relationship between an actor and a forum, in which the actor has an obligation to explain and to justify his or her conduct, the forum can pose questions and pass judgment, and the actor may face consequences" (p. 450).

If accountability were to be discussed within the business discourse, one could refer to Perks (1993)', definition which indicates that:

> "Accountability as a concept may be traced to the separation of ownership from management in business organizations and is related to the concept of stewardship whereby managers provide an account to owners" (p. 24).

An accountability framework is seen to imply justification and explanation of what an accountor has done. It also implies that accountability has to be discharged. Jackson (1982) views accountability as follows:

> "Basically, accountability involves explaining or justifying what has been done, what is currently being done and what has been planned. Accountability

> arises from a set of established procedures and relationships of varying formality. Thus, one party is accountable to another in the sense that one of the parties has the right to call upon the other to give an account of his activities. Accountability involves, therefore, the giving of information" (p. 220).

Giving information in the above definition refers to discharging accountability which is considered as the end point of an accountability relationship. In Stewart's (1984) words, an accountability relationship ends by providing an account (i.e. information). He describes the accountability relationship, as "involving both the account and the holding to account" (p. 16). Some scholars view an accountability relationship as mainly to provide an account. For example, Swift (2001) stated that "essentially accountability is about the provision of information…" (p. 17). Also Gray et al. (1997) offered this statement: "[s]imply stated, accountability is the duty to provide an account of the actions for which one is held responsible" (p. 334). Fitting the notion of providing an account in the accounting context, one could infer that providing accounting information represents a way for accountors to discharge their accountability to accountees.

In other words, financial information is perceived as a way to discharge accountability (Gray et al., 1996). Hopwood (1990) considers the annual report as the major tool by which accountability can be discharged. However, conventional financial reporting might not be regarded as a satisfactory way to discharge one's accountability, Normanton (1966) suggests:

> "To be accountable means, as any dictionary will confirm, to give reasons for and explanations of what one does. But a certified financial account rarely provides explanations, and it never gives reasons. It does not as a rule even contain much detail of what actually has been done... A financial account on any large scale hides far more than it reveals" (p. 1).

Tower (1993) acknowledges that the annual report of a corporate entity is the main tool by which a business enterprise can communicate with its stakeholders but the question of what such a report would contain, according to him, still remains. Providing better financial and non-financial information may help in this regard. He also suggests joint work on stakeholders, producers, and regulators to determine the "equilibrium level" of information.

Stewart (1984) suggests different bases for accountability that an accountor would be accountable for. These bases can summarized in two aspects; first that in respect of the funds with which the accountor was entrusted; here the accountor will be required to prove that funds have been expensed efficiently as planned and in a proper way, which Stewart referred to as "accountability for probity". Second, the accountor has to prove that he/she has acted legally and that entrusted powers have been exercised within appropriate laws and regulations; also the accountor is accountable for "good administration" and for not exercising practices that lead to injustice (Stewart, 1984). Based on these categories, Stewart has introduced what he called a "ladder of accountability" in which different levels of accountability are identified, as shown in Figure 4.1. The lowest level of accountability, according to Stewart's ladder, is accountability for probity and legality which means the accountor is held accountable for misconduct with either entrusted funds or power. The next level refers to the procedures taken by the accountor to ensure the exercise of accountability, in other words, both accountor and accountee can easily exercise their rights[46]. Performance accountability and programme accountability are concerned with whether the accountability system produces the required information. Both levels are concerned with whether accountability has achieved its targets in terms of the accountor's role. Finally at the top of the ladder comes policy accountability which complements both performance and programme accountability in that it ensures that the accountor has taken into consideration the system requirements when conducting his/her responsibility (Perks, 1993).

[46] The right to protect privacy for the accountor when exercising his responsibility to give an account, and the right of the accountee to receive an account.

Figure 4.1: Accountability Ladder

Source: adapted from Stewart (1984).

Within an accountability framework there is a need to distinguish between: "legal and non-legal; or moral or natural, rights and responsibilities" (Gray et al. 1996, p. 39). Most obvious rights and responsibilities are determined by law and are considered the lowest level of rights and responsibilities that, according to the accountability framework, the accountor has to fulfill.

In the following section a differentiation between two notions of accountability will be illustrated, namely narrow and wide notions of accountability.

4.4.2 The Notion of "Narrow" Accountability (Shareholders)

A narrow definition of accountability implies the existence of an explicit contract between two parties (accountor and accountee)[47]. Swift (2001) suggested a contract is essential in the (narrow) accountability relationship and that without it there will be no accountability. She stated that:

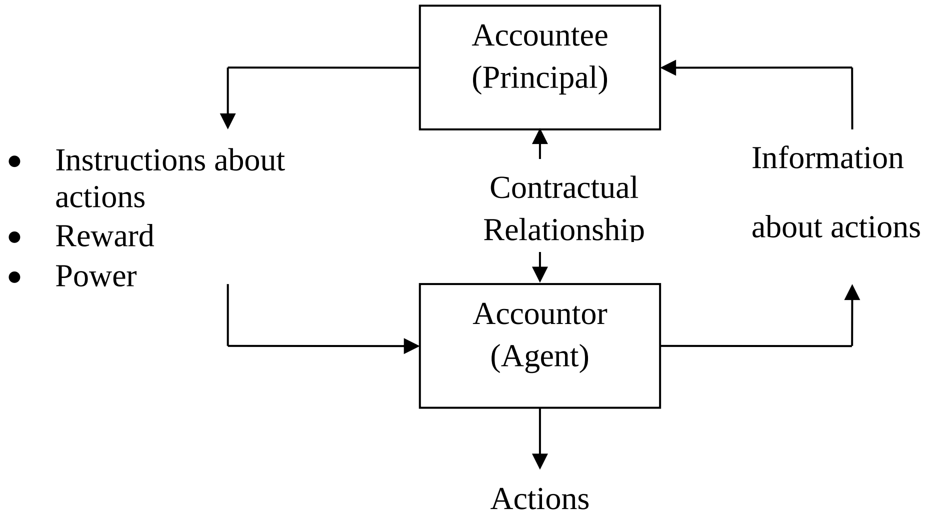
> "Narrow definitions conceive of accountability as being pertinent to contractual arrangements only, asserting that where accountability is not contractually bound there can be no act of accountability" (p. 17).

[47] A contract, or in the words of Gray et al. (1996), an accountability relationship, can be defined by society. In the case of the narrow notion of accountability, the contract can be defined by the Companies Acts (Gray et al., 1996).

A simple example to illustrate the narrow notion of the accountability relationship is given by Gray et al. (1996). Consider a company's directors and shareholders. Directors (accountors) have the duty to look after shareholder's (accountee's) resources either financial or non-financial (managing the company). They are also responsible for providing an account for their mission (i.e. to prepare and provide financial statements). In this simple example, the accountor takes on the responsibility to undertake the management and is responsible for delivering or discharging accountability by preparing and submitting the financial statements. The responsibility to discharge accountability is of great importance and represents the essence of accountability overall. Perks (1993) for example, states that: "accountability means the obligation to give an account" (p. 23). For Swift (2001) the accountability is basically "about the provision of information between two parties…" (p. 17).

It is argued that in order to understand accountability in a specific situation four questions have to be answered; "(1) who is accountable (2) to whom, (3) how (by what means) and (4) for what?" (Perks, 1993, p. 24). In the narrow notion of accountability managers are accountable for the funds they are entrusted with by shareholders. They discharge their accountability by providing accounting information, although Gray et al. (1996) suggest that the discharge of accountability may not, and arguably should not, be only through financial information as managers could and should use narrative accounting as a means to discharge such information. The accountability relationship can be illustrated simply as shown in Figure (4.2).

Figure 4.2: The Accountability Relationship



Source: Gray et al. (1996, p. 39).

According to Swift (2001) the accountability relationship between two parties is usually represented in the form of a principal-agent relationship and a lot of accountability definitions support the notion that the accountability relationship is derived from agency theory[48]. She stated:

> "These definitions underpinning the accountability framework are rooted in economic agency theory which asserts that agents are prey to opportunism if they remain unchecked by regulation or other social controls imposed by society" (p. 17).

Under the principal-agent framework there is a contractual relationship between the two parties and the question of whether this relationship needs to be explicit or implicit can be a controversial issue raising the question of whether an organisation has an implied contractual relationship with society and as a consequence has to provide an account for its actions to society (Swift, 2001). The traditional view of the narrow notion of accountability has been expanded to cover parties from outside the organization. The next section will discuss the wide notion of accountability. To Perks (1993), the accountability relationship is an extension to agency theory. He indicated:

[48] However, Gray et al. (1996) emphasise the importance of distinguishing between an accountability relationship between a principal and an agent and Agency Theory which makes explicit assumptions about the purely self-interested motivations of the parties to the relationship.

> "In the 1970s and 1980s it became fashionable to describe this accountability relationship in terms of 'agency theory'… But the relationship implies much more: shareholders expect not only that good care will be taken of their money, but also that the company will be profitable and perhaps 'efficient' and 'effective'" (p. 24).

4.4.3 The Notion of "Wider" Accountability (Stakeholders)

Accountability has recently been extended to include stakeholders other than only financial investors. According to Connolly and Dhanani (2013):

> "More recently, a second strand of literature which emphasizes the accountability paradigm as the basis for organisational reporting has come to the fore. This paradigm recognises the social, political and wider economic interests of reporting organisations and acknowledges stakeholders other than the financial investor. It is centred on relationships between a wide variety of stakeholders, some of these giving accounts of their behaviour and others receiving or judging those accounts" (p. 3).

This extension may be due to the influence that organisations have on the other stakeholders. "If institutions affect the lives of others, so the argument goes, they [organisations] should be accountable to them [others]" (Steets, 2010, p. 41). Gallhofer and Haslam (1993) argue that an accountability relationship has wider scope than is depicted by an agency-principal relationship. They claim:

> "Accountability is not so much about holding responsible and judging behavior; nor does it assume a simple agency-principal relation… accountability appears equivalent to the ability to render accounts conducive to well-being" (p. 326).

An accountability relationship, according to Ijiri (1983), could be in and/or out of the organisation. In a simple example as shown above (Figure 4.2), this relation could appear between management (accountor) and shareholders (accountee). The accountee group may include, in addition to shareholders, creditors, suppliers, customers, or wider society. An accountability relationship despite its simplest model representing only a two-way relationship between an accountee and an accountor according to Gray et al. (1996) is also more flexible. An accountability relationship exists between employees and management, which, according to Stewart (1984), can be referred to as managerial accountability by which employees are accountor to the management in respect of performing their duties meanwhile management are accountor to employees in respect of offering them a healthy and safe work place (Gray et al. 1996).

Perks (1993) claimed that the concept of accountability could be the consequence of the separation between management and ownership. He stated that: "the accounting model of accountability is based on the idea that, in companies, the owners (or shareholders) are separate from the managers…" (p. 25). He also believed that accountability is a good thing that everyone can benefit from. He added:

> "For simplicity the concept of accountability will be introduced as if there are only two parties involved: directors may be accountable to shareholders, politicians to the electorate, secretaries to managers, or children to parents. In practice, individuals and organizations may be accountable to a number of different parties. Accountability means the obligation to give an account. The extent to which the form and content of that account is defined will vary from one relationship to another" (p. 23).

The wider view of accountability, according to Perks (1993), is that companies are accountable to various groups in society, rather than to only shareholders or perhaps the creditors in the narrow notion, and also that they are accountable in respect of different issues besides the financial position and performance e.g. reporting about social and economic issues of the company's performance which is called corporate social reporting (CSR)[49].

Corporate accountability has developed from the narrow notion to the wide notion, and this expansion of corporate accountability was mainly due to the growing perception that companies working within a society have power (Tower, 1993). Table 4.2 shows the transformation of corporate accountability from the narrow notion to the wide notion.

[49] "CSR" has been used in the literature to refer to corporate social reporting but in recent years the abbreviation "CSR" is more commonly used to refer to corporate social responsibility.

Table 4.2: The Growth in Corporate Accountability

Company managers	Approximate time periods		
	Pre-1930s	**1930s-1960s**	**Post-1960s**
Accountable to:	Shareholders	Shareholders, Employees, Creditors, Customers, Government (Stakeholders)	Shareholders, Employees, Creditors, Customers, Government, General public (Society at large)
Accountable for:	Honest, authorized use of funds	Honest, authorized, efficient and effective use of funds	Honest, authorized, efficient and effective use of funds and socially responsible behavior

Adapted from: Tower (1993, p. 67).

Although accountability is generally seen as beneficial, not all people would view it in the same way. It depends, according to Perks (1993), on the position of the viewer, whether principal or agent. He outlined:

> "Whether or not we are in favour of increased accountability is likely to depend on whether we see ourselves as being the Principal or the Agent in a particular relationship. We are likely to favour increased accountability if we think of ourselves representing society; that we are the Principals; and that powerful individuals (whether politicians, directors, trade union bosses or university vice chancellors) should be more accountable to us. But if we see ourselves as being the Agent (accountable to our boss, parents, electorate or the public) we are less likely to favour any effective system of accountability that restricts our freedom of action" (p. 24).

Considering the restriction that an agent might suffer to their freedom in an accountability relationship Coy et al. (2001) suggest that the accountor seeks ways to avoid such a constraint; they indicated that:

> "Accountability may be related to power relationships between accountors and accountees within organizations, and in society as a whole. More accountability may limit the freedom of agents to act, and as a consequence, they may seek ways to subvert, bypass, and control accountability systems that may be imposed on them. Agents generally control the preparation of accountability information reported to principals, and this provides opportunities for massaging, which may exaggerate strengths and understate weaknesses" (p. 8).

Another limitation to the wider notion of accountability is that the majority of stakeholders would not be able to access the financial information of the firm as they do not possess the legal right for such a procedure.

4.4.4 Accountability Elements of the Libyan Commercial Banks

Perks (1993) provides a number of elements for an accountability system to perform effectively: production of financial information; the audit of accounting information; and the publishing of accounting information. The operating commercial banks in Libya are required by commercial law as well as banking law to prepare and publish their financial statements (see Chapter 2). According to Article (226) of the Libyan Commercial Law, boards of directors of the company have to prepare the financial statements of the company along with notes to them. They are also required to submit a report highlighting the company's activity during the period. Moreover, listed banks have to prepare their accounts according to International Financial Reporting Standards (Kribat, 2009).

The second element of accountability of Perks (1993) is the audit of accounting information. He believes that audited accounting information serves users better than unaudited information. The external audit function starts when the accounting process is completed; it represents the second stage in the process of holding those responsible for the management of an organisation’s finances accountable (White and Hollingsworth, 1999). Literature suggests that the external audit process has become an important factor within the accountability system based on the nature of the audit process[50]. Moreover, it is argued that auditing activities are the direct result of the need for accountability; “accountability is the raison d’etre of auditing activities” (Gong, 2009, p. 5). He concluded that “audits are able to curtail the [misuse of power] by enhancing monitoring and supervision” (p. 6). Therefore, it can be argued that the audit profession should be enhanced given its important role in terms of accountability. Audit, according to White and Hollingsworth (1999), “provides professionally structured and independent information to a variety of actors in the accountability [process]” (p. 9). In this regard, Gong (2009), points out that a

[50] Some scholars, according to Gong (2009), argue that “auditing has strong anticorruption functions” due to the nature of audit work that is dealing with financial accounts, which puts the auditors in a position enabling them to uncover potentially illegal or immoral behaviour.

poor audit system “can leave the door open for irregular and illegal financial behaviors” (p. 6). In this context, Laffan (2003) suggests that financial accountability requires external auditing; she added that accountability is enhanced by the practice of audit in a professional manner as well as by reporting the audits’ findings.

Article (18) of the Libyan Commercial Law requires every company to appoint a licensed auditor to audit its accounts while Article (209) states that an auditor has to issue an auditor's report embodying his opinion on a company's accounting affairs; this report has to assert the auditor’s opinion as to whether a company's accounts are faithfully presented and comply with the law. The auditor's opinion also has to refer to whether accounts have been prepared according to the approved accounting standards[51]. In terms of commercial banks, Banks Law requires that every bank’s accounts have to be certified by two external auditors.

It is suggested that external auditors as well as published financial statements are regarded as part of the mechanism to monitor and control management’s actions (Benston, 1982). The third element identified by Perks (1993) is the publication of accounting information. For accountability to be discharged, accounting information has to be communicated to stakeholders. According to Laffan (2003), accountability is promoted by the publication of the information. As discussed above, the commercial law requires a company to prepare and publish its financial statements; Article (227) indicates the items which a balance sheet of a company has to include (see Chapter 2.3.3.1)

Although the above elements are basically required to ensure an effective accountability system, Perks (1993) acknowledges that in the real world, accountability is often less than predicted. Therefore, a complete and effective accountability process cannot be assumed in Libya.

[51] The law has not defined what approved accounting standards are.

4.5 Theoretical Framework for this Study

Adopting a theoretical framework, as discussed earlier in this chapter, can help the research in a number of ways e.g. in explaining how and why a phenomenon is incurred, and how effective it is. Generally speaking, the accountability framework is believed to be an appropriate framework in research that deals with financial statements. Gray et al. (1996) pointed out that "the accountability framework is the most useful one for analyzing accounting information transmission in general" (p. 32).

This study adopts an accountability based framework. In theory, it describes and matches the relationship between managers and shareholders in the narrow notion, and between managers and society at large in the wide notion. According to the wide notion of accountability, accounting information is used by a wide range of groups i.e. current and potential investors, auditors, regulators…etc, the wide notion also holds that not only financial information would be communicated to these groups[52]. The accountability perspective can be based on the assumption that both accountor and accountee have a conflict of interests. Therefore, it is predicted, according to the accountability theory that both accountor and accountee would try to maximize their own benefits. Chwastiak (1999) argues that "[a]ccording to principal-agent theorists, all human behavior is rooted in self-interest" (p. 431). In a relatively similar vein, Swift (2001) stated:

> "In the accountability paradigm, the agent or organisation's management cannot be trusted to provide information which may best serve stakeholder interests because he or she will inevitably resort to opportunism to promote the organisation's best interests, i.e. those of management or shareholders" (p. 18).

In terms of the earnings management issue, the accountor may be motivated to engage in earnings management practices to ensure maximisation of his/her benefit and the accountee would adopt a mechanism to monitor the accountor's performance through the external audit function. Therefore, the accountability framework can be well suited for

[52] Social information as well as economic information may be communicated (Perks, 1993).

organizations whose services affect many stakeholders who may have both financial and non-financial interests in the organization, in other words, public accountability (Perks, 1993), as is the case with Libyan Commercial Banks[53].

The accountability framework, [as proposed by principal-agent theorists] is deemed to be the proper one to cover this study's objectives as on one hand it conceptually matches well the relationships between a bank's managers and other stakeholders. On the other hand, research findings may be interpreted from the accountability perceptive i.e. recognising the consequences that earnings management practices may have on the accountability system. One of the ways in which accountability is used in the academic context, according to Bovens (2010), is as a "normative concept" to evaluate the actor's behavior. He indicated:

> "Accountability is often used as a normative concept, as a set of standards for the evaluation of the behavior of public actors. Accountability, or more precisely 'being accountable', is seen as a virtue, as a positive quality of organisations or officials. Hence, accountability studies often focus on normative issues, on the standards for, and the assessment of, the actual and active behavior of public agents" (p. 947).

This perspective fits well with this thesis's topic; earnings management, which refers to management intervention in the process of preparing and reporting accounting information which might be biased given the underlying motivations of earnings management behaviour. Tower (1993) recommends, in order to clarify the accountability relationship, asking to whom accountability is owed. One of the research objectives of this thesis is identifying the stakeholders of the Libyan Commercial Banks according to various perceptions.

Moreover, it is suggested that accountability issues have some ethical and moral aspects as well as technical features that affect the trust needed in the accountability relationship (Gong, 2009). Therefore, an accountability framework will be used to interpret the

[53] Public accountability, according to Perks (1993), is applicable to any entity that is responsible to the public. Needless to say, many groups (stakeholders) are or would be affected by commercial banks' activities and performance i.e employees, clients and wider society. As noted in Chapter 1, the recent financial crisis which has had far reaching effects socially in many countries clearly exemplifies this point.

stakeholders' perceptions regarding the ethics of earnings management. If earnings management is regarded as unethical, for example, then one can judge about accountability as being compromised when it is acknowledged, or believed to be the case, that earnings management practices have been conducted.

Based on the above discussion and taking into consideration the objectives of this study, the accountability framework properly meets this thesis's objectives.

4.6 Summary

Accountability relationship implies an accountor to provide an account to the accountee in order to discharge his/her accountability, within accountability; the aim is to restrict the accountor from misusing the power that could affect others' interest. This chapter provides a context within which to understand the accountability framework and its relationships. First, section 4.2 considered the theory definition and its importance in accounting research. Section 4.3 outlined the conceptual frameworks of accounting as suggested by Ijiri (1983) that are accountability and decision usefulness; it also examined the distinction between these two theoretical frameworks. Section 4.4 examined the accountability framework; the accountability concept was discussed and defined and two notions of accountability were outlined. Section 4.5 justified the accountability conceptual framework for this study. In the next chapter the study's methodology and methods are discussed.

Chapter 5

Research Methodology and Methods

5.1 Introduction

The previous chapter outlined the theoretical framework of this study. The study methodology as well as the adopted methods to carry out the empirical work of this study will be discussed in this chapter. Alternative methodological frameworks that are extant in the literature will be outlined. Then this study's methodology, methods and paradigm will be explained.

5.2 Social Research Philosophy and Approaches

The literature offers numerous definitions for research. For example, Goddard and Melville (2001) perceive research as the "discovery and the creation of knowledge". They argue that "[e]verything we now know had to be discovered by someone at some time". They outlined the significance of pursuing research by suggesting that without it one could be "naked, homeless and penniless…" (p. 1). To Burns (2000) research is a "systematic investigation to find answers to a problem" (p. 2). In the context of social research, including accounting[54], Williams (2003) defined it as "the means by which social scientists understand, explain and predict the social world" (p. 1). Sarantakos (2005) considered that social research is about "discovery, expanding the horizons of the known, confidence, new ideas and new conclusions about all aspects of life". He noticed that social research itself has become the main objective for the social scientist. He stated:

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[54] Research in accounting is social science research, Ryan et al., (2002) claim that "[r]esearch in accounting and finance is generally accepted as being social scientific, as appropriate standards of scientific enquiry are applied to social issues rather than natural phenomena, which is taken to be the domain of the natural sciences and of physics in particular" (p. 9).

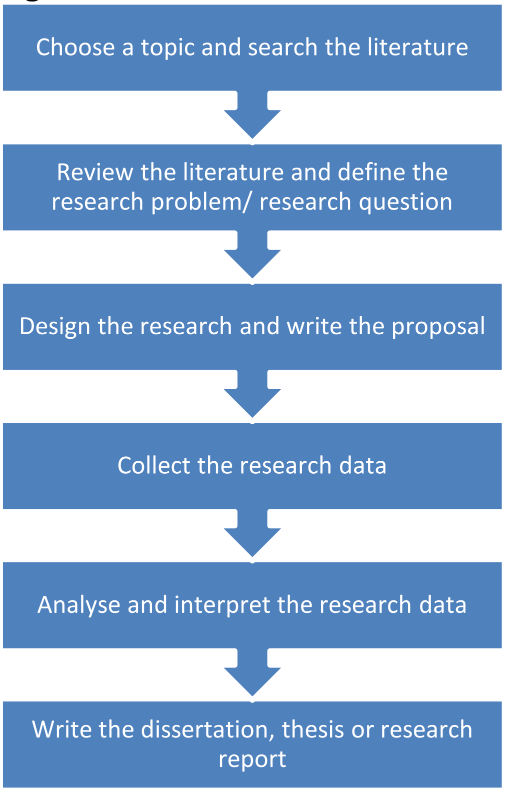
> "As the quest for knowledge, social research has been the ultimate goal of the social scientist, who basically seeks not only to gather useful and valid knowledge, but also to educate the community about the status and validity of certain 'source' of knowledge" (p. 4).

Rugg and Petre (2007) advocate that research leads to something new and in this context they distinguish between two types of research; primary research by which the findings are new to everyone and secondary research in which findings are not necessarily new to everyone but are actually new to the researcher.

Social researchers, according to Sarantakos (2005), may be motivated for a number of reasons including: educational and institutional. Educational motivation suggests that a social researcher is conducting the research for the purpose of education and informing the public about the social problem or issue. On the other hand, institutional motivation denotes a researcher's determination to "enhance the research quantum of the institution for which the researcher works" (p. 13). Scanlon (2000) classified the purpose of research into three main categories: (a) to contribute to a specific field or knowledge; (b) to contribute to a debate or inform policy; and (c) to examine a particular problem or issue (p. 2). He claims that research could be carried out in order to satisfy one or more of the above purposes as they are not mutually exclusive.

According to Kumar (2005), the process of research implies that the research is conducted "within a framework of a set of philosophies" (p. 6). He also pointed out that research should be objective and unbiased and, in order to achieve its goals, a researcher should be using "procedures, methods and techniques that have been tested for their validity and reliability" (p. 6). Kumar has defined research as "a process for collecting, analysing and interpreting information to answer questions" (p. 7). Collis and Hussey (2009) summarize the research process as shown in Figure 5.1.

Figure 5.1: The Research Process



Source: Collis and Hussey (2009, p. 10).

According to Easterby-Smith et al. (2002), understanding the philosophical research issues is of great importance to the researcher for at least three reasons. First, understanding these issues would help the researcher to better design the research; for example, it helps in deciding what evidence is to be collected and from where; it also enhances the researcher's ability to interpret it. Second, it puts the researcher in a position so as he/she is able to decide whether a research design works or not. Third, by understanding these issues the researcher will be able to identify any research design that he/she is capable of; it can, according to Esaterby-Smith et al. (2002), help the researcher to:

> "Identify, and even create, designs that may be outside his or her past experience. And it may also suggest how to adapt research designs according to the constraints of different subject or knowledge structures" (p.27).

The literature documents two main approaches that form the basis of research in the social sciences. Before the 1960s there was only one approach for social science research; that was the traditional scientific approach which employs quantitative methods for data collection and which can also be described as an objective or quantitative approach. Since the 1960s social science research established a new approach namely the qualitative or subjective approach to carry out research using qualitative methods for data collection (Burns, 2000; Kumar, 2005; Collis and Hussey, 2009).

Collis and Hussey (2009) define the research approach as the “philosophical framework that guides how scientific research should be conducted” (p. 55). According to Collis and Hussey (2009) there is only one research approach, that is, positivism, which is referred to in the natural sciences. After the emergence of social science the second paradigm existed which is called “social science”. These two main approaches are shown in the Figure 5.2. Rubin and Rubin (2005) suggest that research philosophy implies how to study the world.

Figure 5.2: A Continuum of Approaches

Source: Collis and Hussey (2009, p. 57)

The positivism approach, according to Collis and Hussey (2009), “rests on the assumption that social reality is singular and objective, and is not affected by the act of investigation” (p. 56). On the other hand, the interpretivism approach “rests on the assumption that social reality is in our minds, and is subjective and multiple” (p. 57). Other terms can be used to describe the above approaches. Table 5.1 shows these terms.

Table 5.1: Research Approaches

The two main approaches for social research	
Positivism	Interpretivism
Quantitative	Qualitative
Objective	Subjective
Scientific	Humanities
Traditionalist	Phenomenological

Source: Collis and Hussey (2009, p. 58)

These two approaches are different in terms of philosophical assumptions that support modes of inquiry, methods, models and procedures[55] (Kumar, 2005, Collis and Hussey,

[55] Creswell (2003, 2009), classifies research approaches as; qualitative, quantitative, and mixed methods. He argues that there is not, in today’s research, a pure neither quantitative nor qualitative research rather than a

2009). Although, the two main research approaches -quantitative (positivism) and qualitative (interpretivism)- may have a similar process, they are different in terms of methods, data analysis and the "style of communication of the findings" (Kumar, 2005, p. 17). Kumar (2005) outlined the distinctions between the two main research approaches.

Table 5.2: Differences between Quantitative and Qualitative Research

Difference with respect to:	Quantitative research	Qualitative research
Underpinning philosophy	Rationalism: 'That human beings achieve knowledge because of their capacity to reason' (Bernard 1994: 2)	Empiricism: 'The only knowledge that human beings acquire is from sensory experience' (Bernard 1994: 2)
Approach to inquiry	Structured/rigid/ predetermined methodology	Unstructured/flexible/open methodology
Main purpose of investigation	To quantify extent of variation in a phenomenon, situation, issue etc.	To describe variation in a phenomenon, situation, issue etc.
Measurement of variables	Emphasis on some form of either measurement or classification of variables	Emphasis on description of variables
Sample size	Emphasis on greater sample size	Fewer cases
Focus of inquiry	Narrows focus in terms of extent of inquiry, but assembles required information from a greater number of respondents	Covers multiple issues but assembles required information from fewer respondents
Dominant research value	Reliability and objectivity (value-free)	Authenticity but does not claim to be value-free
Dominant research topic	Explains prevalence, incidence, extent, nature of issues, opinions and attitudes; discovers regularities and formulates theories	Explore experiences, meanings, perceptions and feelings
Analysis of data	Subjects variables to frequency distribution, cross-tabulations or other statistical procedures	Subjects responses, narratives or observation data to identification of themes and describes these
Communication of findings	Organisation more analytical in nature, drawing inferences and conclusion, and testing magnitude and strength of a relationship	Organisation more descriptive and narrative in nature

Source: Kumar (2005, pp. 17-18).

The philosophical assumptions that underpin the above two paradigms are ontology, epistemology and human nature. Once a researcher has determined the ontological and epistemological assumptions for the research based on his/her human nature he/she should be able to decide about the methodology to be applied in the research (Burrell and Morgan, 1979). These assumptions are discussed in the next section.

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combination of the two. He indicates: "The situation today is less quantitative versus qualitative and more how research practices lie somewhere on a continuum between the two. The best that can be said is that studies tend to be more quantitative or qualitative in nature" (2003, p.4). As for the mixed approach, he claims that it is "an approach to inquiry that Combines or associates both qualitative and quantitative forms" (2009, p. 4). This approach, according to Creswell (2009), is based on the mixing of both qualitative and quantitative approaches in a study.

5.3 Assumptions about the Nature of Social Science

Under the two dimensions of approaches to carry out social science research (namely subjectivist and objectivist approaches) Burrell and Morgan (1979) classified four categories of philosophical assumptions: ontology, epistemology, human nature and methodology. Figure 5.3 demonstrates the Burrell and Morgan (1979) classification.

Figure 5.3: The Subjective-Objective Dimensions

The subjectivist approach to social science				**The objectivist approach to social science**
Nominalism	←	**ontology**	→	Realism
Anti-positivism	←	**epistemology**	→	Positivism
Voluntarism	←	**human nature**	→	Determinism
Ideographic	←	**methodology**	→	Nomothetic

Source: Burrell and Morgan (1979, p. 3).

According to Burrell and Morgan (1979) philosophical assumptions will be viewed differently under these two approaches. Grix (2004) considers ontology as the starting point of all research for which, once identified, the epistemological and methodological assumptions become clear and "logically follow" (p. 59).

Collis and Hussey (2009) indicate that the ontological assumption is about dealing with the nature of reality and they note that these assumptions are viewed differently according to the research paradigm. They conclude that positivists (the objective approach) consider that reality is "objective and external to the researcher" (p. 59) and as a consequence there will be "only one reality". Burrell and Morgan (1979) argue that social scientists are faced with the question of whether reality (the issue that is under investigation) is separated from the individual and exists as an object in the world or whether reality is constructed in the individual's mind. Ryan et al. (2002) indicate that the ontology assumption rests on the study of existence; in other words on how researchers perceive that reality is constructed. "Reality is a difficult concept but is concerned with the construction of existence in objects" (p. 13). Moses and Knutsen (2007, p. 5) define ontology as "the study of being" which is based on the question "What is the world really made of?" Based on this notion, ontology could be described either as realism or idealism. Under the objective approach the ontological assumption would be realism which means "social reality is objective and external to the individual". Realism simply reflects the rational view that reality is "independent of our perception" (Ryan et al., 2002). On the other hand, interpretivist (subjectivist) researchers perceive reality as subjective and socially constructed. Reality, according to Sarantakos (2005, p. 41), exists in people's mind and "each person constructs his/her own reality, which is therefore subjective". As a consequence of people having different perceptions there would be as many realities as people.

Subjectivism, according to Burns (2000, p. 3), recognises ontology as idealism and the social reality is then considered as "a creation of individual consciousness". Walliman (2005) compared the realism and idealism ontological assumptions: realism assumes that "the world exists and is knowable as it really is"; organisations are regarded as real objects "with a life of their own". According to the idealism perspective, the world does exist but is interpreted by different people in different ways as "different people construe it in very different ways". In contrast to realism, the idealism perspective considers organisations as a social reality (p. 205). In this regard, Burrell and Morgan (1979) argue that realism assumes that the social world is "external to individual cognition" and exists separately from an individual's perception. They consider the social world as absolutely made up of physical components and as a "reality of its own" (p. 4). In contrast, the nominalism (idealism) position views the social world as being constructed only by nothing but "names, concepts and labels". They further describe these names as "artificial creations" that could be used to describe reality only in accordance with nominalists' convenience.

Related to the ontological assumption is the epistemological assumption. Epistemology rests on the idea of how can individuals understand the world and communicate this understanding to other people. Gribch (2007) explains that the origin of the term “epistemology” comes from the Greek language and consists of two words; episteme which means knowledge and logos which means theory. She added that epistemological assumptions concern the nature of evidence and therefore what is accepted to be truth and how it is constructed? Other questions taking place in social research are related to ontological assumptions about the nature of the social world and reality. In this context, questions of “what do we know? and how can we know this? are important. (Gribch, 2007). The epistemological assumption, according to Collis and Hussey (2009), is “concerned with what we accept as valid knowledge” (p. 59). They demonstrate that positivist (objectivist) researchers consider phenomena as valid knowledge only when it can be observed and measured. In this context, Sarantakos (2005, p. 30) suggests that the “[o]ntological, epistemological and methodological prescriptions of social research are ‘packaged’ in paradigms (approaches) which guide everyday research”. He also claimed that “realist/objectivist ontology and empiricist epistemology, guides the strategy of quantitative methodology” and therefore employs quantitative methods. On the other hand, a “constructionist ontology and an interpretivist epistemology, guide the strategies of qualitative methodology” based on qualitative methods

Moses and Knutsen (2007, p. 5) described epistemology as “a more straightforward term” that is concerned with the “study of knowledge”. According to them the term epistemology basically holds the question “[w]hat is knowledge?” The epistemological assumption according to Burrell and Morgan (1979), deals with the “grounds or knowledge” which implies how knowledge can be gained and how to distinguish between true and false knowledge. Two positions will reflect the epistemology assumptions: anti-positivism and positivism. In the words of Burrell and Morgan (1979), epistemological assumptions represent the extreme positions about whether knowledge can be "acquired on the one hand, or is something which has to be personally experienced on the other" (p. 2) as is the case in anti-positivist epistemology. From the standpoint of anti-positivism, the social world can be understood based on the involved individuals' viewpoint. They perceived the social world according to this view as being "essentially relativistic" and in order to understand what is happing in the social world one has to get involved inside rather than being an observer as in the case of positivism. According to the positivist viewpoint, the social world is regulated and its components are governed by causal relationships. Thus positivism is concerned with explaining and predicting the relationships included in the social world. Burrell and Morgan (1979) characterise positivists as taking the role of observer rather than getting involved to understand the social world.

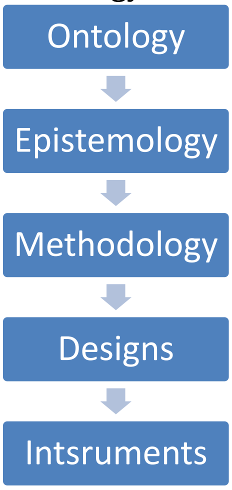
The ontology and epistemology of research are related issues. Crotty (1988) argues that ontological and epistemological issues normally arise together. To Grix (2004) ontology and epistemology represent the foundation of research. He stated: "ontology and epistemology are to research what 'footings' are to a house: they form the foundation of the whole edifice" (p. 57).

The third assumption is correlated with ontological and epistemological assumptions and involves human nature assumptions. According to Burrell and Morgan (1979) the human nature assumption implies the relationship between human beings and their surroundings. They claim that it is based on the importance of "human life" and that it represents the key factor of knowledge. All social sciences have to regard this fact and take into consideration human nature assumptions. They identified two positions of human nature in social science namely voluntarism and determinism. The determinism perspective considers human beings and their experience as not free and that they are "products of the environment" (p.

2) and "determined by the situation" where they are located. By contrast, the voluntarism perspective views human beings as free, independent and creative who create their environment and control it (Burrell and Morgan, 1979).

The assumptions discussed above will have, according to Burrell and Morgan (1979), a direct impact on the methodological assumptions of social science research. Each assumption will affect the way by which knowledge is viewed, obtained and investigated though different ontological, epistemological and human nature assumptions, and will definitely direct social scientists toward different methodologies. Methodology is defined as "the strategy, plan of action, process or design lying behind the choice and use of particular methods and linking the choice and use of methods to the desired outcomes" (Crotty, 1998, p. 3). Research methodology means how knowledge is acquired. It basically rests on the question "[h]ow do we know?" (Moses and Knutsen, 2007, p. 5). Methodology then is the process of how to conduct a research. This conduct, according to Sarantakos (2005) is affected by the theoretical ontology and epistemology assumptions. He defines the methodology simply as "the nature of research design and methods" (p. 30). Figure 5.4 demonstrates his notion.

Figure 5.4: Methodology Process



Source: Sarantakos (2005, p. 29).

One may be conflicted between the terms methodology and method: "[m]ethods and methodology, two words that are often confused, used interchangeably and generally misunderstood" (Grix, 2004, p. 30). In this regard, Payne and Payne (2004) demonstrate that "the term 'methodology' in a literal sense means the science or study of methods" (p. 150) whereas, methods are "the specific techniques used in social research" (p. 149). Methods, according to Payne and Payne (2004), could be classified into two categories; qualitative methods and quantitative methods. In the same vein, Moses and Knutsen (2007) indicate that the term methodology can result in "ambiguity" and one may conflate it with methods; sometimes it is used as a fancy synonym for method. They define methodology as "an investigation of the concepts, theories and basic principles of reasoning on a subject"; in the social science context methodology refers to "philosophy of science applied to the social science" (pp. 5-6). Sachdeva (2009) offered a distinction between methods and methodology as shown in Table 5.3.

Table 5.3: The Distinction between Method and Methodology

Method	Methodology
Techniques for gathering evidence.	The underlying theory and analysis of how research does or should proceed, often influenced by discipline.
The various ways of proceeding in gathering information.	"an epistemology" is a theory of knowledge. It is the theory that decides that

Source: Sachdeva (2009, p. 7).

Burrell and Morgan (1979) identified two extremely different methodologies: the nomothetic and ideographic perspectives. According to the nomothetic methodology perspective the social world is considered as objective reality. The alternative perspective is ideographic which views social reality as created by individuals' subjective experience and that the social world can be understood only by getting preliminary knowledge about the subject. This view, according to Burrell and Morgan (1979), is concerned with the analysis and getting involved in day-to-day situations. On the other hand, the nomothetic position is concerned with the significance of quantitative methods for testing hypotheses by data analysis.

Moses and Knutsen (2007) suggest two main methodologies under which “most work in social science can be grouped” (p. 3). They added, “[T]hese two different methodologies incorporate radically different views of the world and how we can come to understand it” (p. 3). To define methodology they draw on Waltz (1979) who stated:

> “They (students) have been much concerned with methods and little concerned with the logic of their use. This reverses the proper priority of concern, for once a methodology is adopted, and the choice of methods becomes merely a tactical matter. It makes no sense to start the journey that is to bring us to an understanding of a phenomenon without asking which methodological routes might possible lead there” (Waltz, 1979, p. 13).

5.4 Assumptions about the Nature of Society

Burrell and Morgan (1979) noted that Dahrendorf (1959) and Lockwood (1956) identified two approaches for sociology that explain the nature of social order on one hand and that are concerned with the "problem of change" on the other hand. This conflict in approaches has resulted in what became known as the order-conflict debate. Based on this notion, Burrell and Morgan (1979) recognised two approaches in research assumptions relating to the nature of society. This distinction is articulated in Figure 5.5.

Figure 5.5: Two Theories of Society: 'order' and 'conflict'

The 'order' or 'integrationist' view of society emphasises:	The 'conflict' or 'coercion' view of society emphasises:
Stability	Change
Integration	Conflict
Functional co-ordination	Disintegration
Consensus	Coercion

Source: Burrell and Morgan (1979, p. 13).

Burrell and Morgan (1979) have criticised the above distinction as being "most problematic". They instead introduced alternative terms; sociology of regulation and sociology of radical change. The former refer to theories that are concerned about explanations of society and support its "unity and cohesiveness". They argue that the main challenge that the sociology of regulation faces is the unity of society and therefore it is trying to explain and justify this unity. The sociology of radical change, in contrast, refers to radical change explanations. This sociology is concerned with alternative possibilities rather than accepting the “status quo” position. Burrell and Morgan’s (1979) distinction between these two sociologies is articulated in Figure 5.6.

Figure 5.6: The Regulation-radical Change Dimension

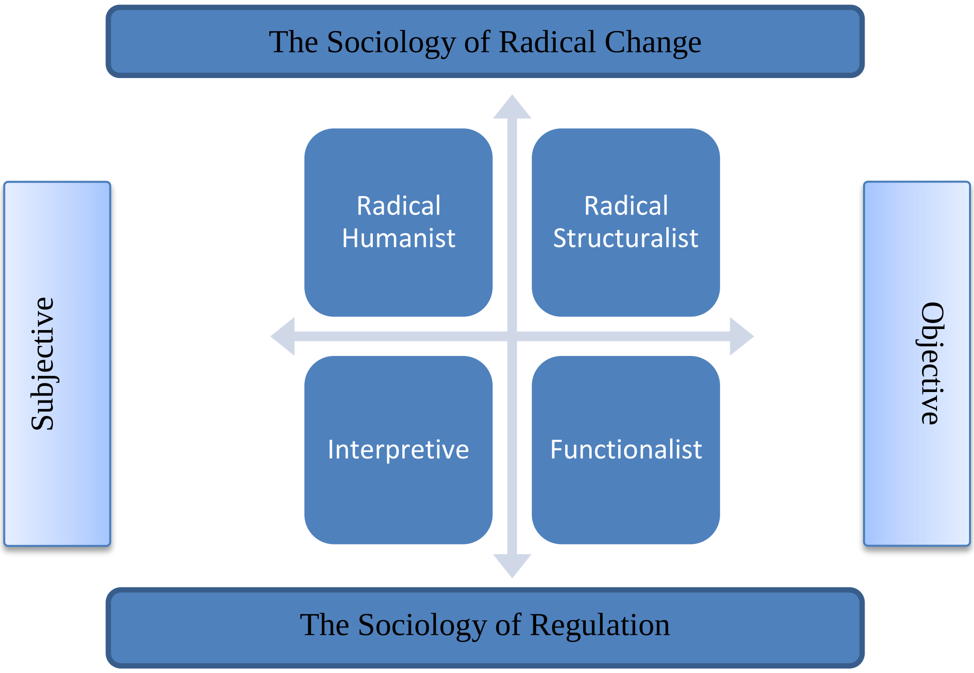
The sociology of REGULATION is concerned with:	**The sociology of RADICAL CHANGE Is concerned with:**
The status quo	Radical change
Social order	Structural conflict
Consensus	Modes of domination
Social integration and cohesion	Contradiction
Solidarity	Emancipation
Need satisfaction	Deprivation
Actuality	Potentiality

Source: Burrell and Morgan (1979, p. 18).

5.5 Burrell and Morgan’s Framework

Burrell and Morgan (1979) distinguished between the philosophical assumptions about the nature of social science according to the subjective-objective dimension. They also divided the assumptions about society into two dimensions; radical change sociology and regulation sociology. Based on this notion, Burrell and Morgan (1979) developed four paradigms for research in social science by combining the subjective-objective dimensions with radical change-regulation sociological dimensions. This combination resulted in four social science research paradigms. The four paradigms are classified as follows: (a) the radical humanist; (b) the radical structuralist; (c) the interpretive; and (d) the functionalist. Figure 5.7 articulates the four paradigms for social science research adopted by Burrell and Morgan (1979).

Figure 5.7: Four Paradigms for the Analysis of Social Theory



Source: Adapted from Burrell and Morgan (1979, p. 22).

Burrell and Morgan (1979) claim that all social theory can be located within the four paradigms which they described as a "map" that is used to negotiate the research subject. Indeed, they have gone further to recognise that by this map one can locate a "personal frame of reference" in terms of social theory. Moreover, this map enables the researcher to recognise where he/she is and potential directions to take in the future.

The radical humanist, according to Burrell and Morgan (1979), is a research paradigm that is concerned with developing the sociology of radical change through a subjective view of the world. It approaches social science from a perspective that is; nominalist, anti-positivist, voluntaristm and ideographic. This paradigm rejects the notion 'status quo' and considers society as "anti-human"; thus it is trying to "release" the social society from its constraints (Burrell and Morgan, 1979).

Theories that recognise the sociology of radical change from an objective viewpoint locate themselves in the radical structuralist paradigm and approach the sociology of radical change from a realist, positivist, determinist and nomothetic standpoint. This paradigm according to Burrell and Morgan (1979) is “committed to radical change, emancipation, and potentiality, in an analysis which emphasises structural conflict, modes of domination, contradiction and deprivation” (p. 34).

The functionalist paradigm reflects the sociology of regulation perspective and employs objectivist methods to approach the subject. This paradigm has been broadly characterised as “pragmatic orientation” for attempting to understand society as it is. It accepts the “status quo” and is “problem-oriented” for providing rational explanations that are practical and would be usable by society. Sociological assumptions imply that issues are investigated objectively or in other words from a “realist, positivist, determinist and nomothetic” perspective (Burrell and Morgan, 1979).

The interpretive paradigm, according to Burrell and Morgan’s (1979) classification, adopts the subjective dimension in terms of social science assumptions and the sociology of regulation in terms of the nature of society assumptions. This paradigm tends to accept the social society as it is i.e. the ‘status quo’ from a subjective standpoint. In other words, it is emphasising understanding day-to-day social life by examining individual perceptions about the rules and regulation that govern their relationships. Researchers based in this paradigm will be, in terms of theoretical assumptions, nominalist, anti-positivist, voluntarist and ideographic (Burrell and Morgan, 1979).

Burrell and Morgan (1979) argue that the aforementioned paradigms are “mutually exclusive” as they provide “alternative views of social reality” (p. 25) so they state: “they [paradigms] should be viewed as contiguous but separate” (p. 23).

5.6 Research Paradigm and Methodology

This study aims to investigate the perceptions of different stakeholders about the earnings management behaviour in the LCBs. It locates itself in the interpretive paradigm. In the interpretive paradigm, the researcher elicits the individuals’ perceptions toward an issue as is done in this study. The previous chapter highlighted that the results of this study will be discussed from the accountability perspective; in other words the conceptual framework of this study is accountability. In addition to the above aims; this study is focusing on the accountability relationships of banks managers with; shareholders and other stakeholders. By other words, this study tries to examine whether evident accountability relationships are taking place in the context of financial reporting of the Libyan Commercial Banks. It also seeks to investigate how this accountability might be improved as one of this study objectives.

5.7 Research Methods

Research methods are tools by which research data is collected and analysed. Payne and Payne (2004) define social research methods as "the technical practices used to identify a research question, collect and analyse data and present findings" (p. 149). Hinds (2000) refers to research methods as "the tools you use to collect and structure data thus transforming it into useful information" (p. 41). Walliman (2011) argues that when a research problem is identified, it would be easy for a researcher to determine the required data and how to analyse it. When it comes to research methods, social research can be divided into two groups; qualitative and quantitative research. This distinction, according to Walliman (2001), is attributed to the different data characteristics of both groups and different analysis or techniques used. Smith (2011) states that the choice of a research method depends on three factors; the research question, data access, and what researcher wants to do. He argues that there is no single method that could be regarded as the best for all research, and according to him, for research that seeks out opinions, beliefs or factual information, surveys and interviews might be the proper methods. This study will employ two research methods; semi-structured interviews and a questionnaire survey.

5.7.1 Semi-Structured Interviews

The first method applied in this study was semi-structured interviews. These interviews were undertaken in two periods; Jun-Aug 2011 and May-Jul 2012[56]. Interviews, according to Eriksson and Kovalainen (2008) are commonly used in qualitative research. Gillham (2000) defined the interview as a conversation between interviewer and interviewee in which the interviewer "is seeking responses for a particular purpose from the other person" (p. 1). He also indicates that interviews are normally conducted in research "to obtain information and understanding of issues relevant to the general aims and specific questions of a research project" (p. 2). Robson (2007, p. 73) states that "the heart of the interview technique is one person (the interviewer or researcher) talking to one or more other persons (the interviewees or participants)". According to Robson (2011) interviews can be divided into three types; structured, semi-structured and unstructured interviews. He distinguished between the three types as follows: structured interviews consist of prepared fixed questions in a predetermined order. In unstructured interviews "the interviewer has a general area of interest and concern" (p. 280) and administrates the process allowing it to develop in the area and accordingly this type may be informal. With semi-structured interviews, the interviewer has a "shopping list" of issues to be covered and has the latitude to modify the words and order of questions according to the interview process (Robson, 2011, p. 285). Questions in semi-structured interviews are normally specified, but the interviewer is freer to probe beyond the answers in a manner which would appear prejudicial to the aims of standardization and comparability" (May, 2011, p. 134). This makes the semi-structured interviews flexible. Semi-structured interviews have the advantage of flexibility in that the same questions are being asked to all participants but there is scope for individuals to develop additional areas of interest to them. Gillham (2005) describes this method as "the most important way of conducting a research

[56] Due to the Libyan revolution of 17th Feb interviews in the first period Jun-Aug 2011 took place in the liberated city of Benghazi. In the second period May-Jul 2012 stakeholders from Tripoli (capital) were interviewed.

interview because of its flexibility balanced by structure, and the quality of the data so obtained" (p. 70). Also, flexibility could mean that a researcher has the opportunity to change the planned sequence of questions rather than being attached to the pre-planned question order. In this context, Robson (2007) indicates that:

> "If the interviewee comments on something you had planned to cover later, you don't choke them off. Go with it. If something is disturbing, you don't follow it up with something likely to be more so. More on to something else and return later". (p. 74).

In addition to being flexible, Creswell (2003) suggested that an interview is a useful method when participants cannot be observed; it is also beneficial when participants are able to provide historical information. Creswell (2003) has also noticed some limitations of interviews:

> "(i) provides indirect information filtered through the views of interviewees, (ii) provides information in a designated place rather than the natural field setting, (iii) researcher's presence may bias responses and (iv) people are not equally articulate and perceptive" (p. 186).

Reporting interviews' findings, according to Creswell (2003), depends on whether the research is qualitative or quantitative. When a qualitative approach is adopted, as the case of this study, findings would take the form of narrative text rather than numerical form.

> "This is a naturalistic study. Therefore, the results will be presented in descriptive, narrative form rather than as a scientific report" (Creswell, 2003, p. 205).

The first empirical work of this study is based on 28 interviews with various stakeholders. These interviews were conducted mainly to clarify and investigate the perceptions of those stakeholders about the issue of earnings management and its related issues including the role of the external auditor as part of a corporate governance mechanism. Interview results were used to prepare and design the questionnaire.

5.7.2 Questionnaire Survey

The questionnaire survey represents one of the most important and widely used data collection methods in social science research and this is attributed, according to Gray

(2009), to it being easy to design for researchers. He defined questionnaires as "research tools through which people are asked to respond to the same set of questions in a predetermined order" (p. 337). A questionnaire survey is regarded as a "useful tool" for data collection when information is required from a large number of respondents (Hinds, 2000). Questionnaires are useful and flexible tools that can be used to collect both quantitative and qualitative information (Walliman, 2011). Rugg and Petre (2007) describe the questionnaire by saying "[i]t is, in essence, a list of questions" (p. 142) a researcher prepares in advance to present to respondents who will either answer these questions by using their words or by picking the suitable answer from a set of alternatives.

The first challenge a researcher faces in designing the questionnaire is the choice of questions to ask. Rugg and Petre (2007) argue that questionnaires "are very easy to use badly, and are very rarely used well" (p. 141). In the same vein, Gillham (2008) claims that "good research cannot be built on poorly collected data" (p. 1) so a questionnaire has to be developed in way that produces "good" data. This cannot be achieved unless questions are prepared adequately. In addition, a questionnaire is the preferred method to gather data for a number of reasons; Gillham (2008) suggests the following advantages for using questionnaires to collect research data:

> "Low cost in time and money, easy to get information from a lot of people very quickly, respondents can complete the questionnaire when it suits them, analysis of answers to closed questions is straightforward, less pressure for an immediate response, respondents' anonymity, lack of interviewer bias, standardization of question (but true of structured interview), and can provide suggestive data for testing an hypothesis" (Gillham, 2008, p. 6).

He also lists some drawbacks of using a questionnaire; for example, the accuracy and quality of data, the response rate[57] and questions being misunderstood. In an attempt to tackle such issues of misunderstanding, this study adopts, in addition to the questionnaire,

[57] High proportion of the questionnaires will be distributed to people personally known to the researcher, what Gillham (2008) refer to as "sample captive". He also advised the length of the questionnaire should not exceed the four or six pages length.

the semi-structured interviews. Semi-structured interviews have been undertaken prior to the questionnaire survey in order to explore issues that might be unclear or conflated so helping to avoid such problems when designing the questionnaire.

5.7.2.1 Types of questionnaires

Sarantakos (2005) differentiates among questionnaires according to their nature and the way they are administered. He identified three types of questionnaire; standardised, unstandardized and semi-standardised questionnaires. In the standardised type the questions require inflexible answers and respondents will choose an answer from a set of alternatives. The unstandardized type consists of open questions which give the respondents leeway for answering. The semi-standardised questionnaires lay in between the above two types. They will include both structured and unstructured questions.

5.7.2.2 Pilot Testing

Piloting the survey is, according to Smith (2011), a crucial step to ensure that a questionnaire is well designed and will produce useful responses from the selected sample. He argues that at the pilot stage, the whole survey should be assessed and this step is of importance so as questionnaire reliability is improved and the questions asked are valid. Smith (2011) acknowledged that pilot tests are usually conducted on academic colleagues and suggested that other members of the target population also be tested. In order to improve the reliability of this study's questionnaire, the questionnaire was tested on academic colleagues as well as external auditors.

5.8 Summary

This chapter highlighted the philosophical assumptions that underlie the social research and the nature of the society according to Burrell and Morgan's (1979) perspective. It also outlined the adopted research paradigm of this study 'interpretive' and the data collection methods that are employed in this study. In the next two chapters the analysis of the collected data will be reported.

Chapter 6

Interviews Analysis

6.1 Introduction

The previous chapter highlighted the research methods used in this study. The first method employed in this study is the semi-structured interviews. Twenty eight interviews have been conducted with various stakeholders in order to elicit their perceptions about the quality of financial reporting, the phenomenon of earnings management, and other related issues including any motivations and constraints affecting the practice of earnings management in the Libyan banking sector. This chapter presents the results of these interviews. The chapter is structured as follows. Section 6.2 lists the interview questions and interviewees' educational background and professional role. Section 6.3 describes and examines the interviewees' perceptions about the quality and importance of financial reporting in Libya. Section 6.4 explores the interviewees' perceptions of: earnings management and awareness of it; earnings management constraints and motivations; and, how interviewees perceive earnings management in terms of business ethics. Section 6.5 analyses the interviewees' responses about the role of accounting standards, corporate governance and the external audit in deterring earnings management practices in Libyan Commercial Banks. Section 6.6 provides a summary of this chapter.

6.2 Interview Questions and Interviewees

The questions for the interview can be divided into three principal categories; (i) financial reporting quality and importance (6.3); (ii) earnings management and its definition, meanings, motivations and ethics (6.4); and (ii) the role of accounting standards, corporate governance and the external auditor in mitigating the practice of earnings management (6.5). To cover these issues, interviewees were asked in total 19 questions. The list of interview questions can be seen in Table 6.1.

Table 6.1: Interviews Questions List

1	What is your opinion about the overall quality of financial reporting in Libya, particularly for listed companies?
2	Why is financial reporting important? Who is it important to?
3	Are you familiar with the term earnings management?
4	What do you understand by the term earnings management?
5	Do you think that earnings management is practiced in Libya and if so, to what extent?
6	In particular, do you think that earnings management is practiced in the banking sector and if so, to what extent?
7	Who do you regard as the main stakeholders in banks?
8	Are you aware of any techniques that may be used to manage earnings both generally and particularly in the banking sector?
9	Which factors do you think may influence the extent of earnings management?
10	What in your view are the possible motives for earnings management both in general and in the banking sector?
11	How do you perceive the practice in terms of business ethics?
12	Do you think that absence of local accounting standards influences the practice of earnings management?
13	Do you think that adopting IFRS could affect earnings management? How?
14	Could you comment on the impact of good corporate governance in relation to earnings management?
15	Could you comment on the ability of the external audit function to detect and/or deter earnings management?
16	What is your assessment of the effectiveness of external audit of banks in Libya?
17	To what extent do you think that stakeholders rely on the auditor's report?
18	Do you have any other view on the topic of earnings management in the Libyan banks?
19	Do you think that accounting manipulation could be used in other ways to mislead stakeholders e.g. in relation to capital adequacy and overall financial position?

Twenty eight interviews were conducted in the two main cities of Libya: Benghazi and Tripoli, the capital. The first 20 interviews took place in the period Jun-Aug of 2011 in the city of Benghazi at a time when the capital had not been liberated[58]. The remaining eight were conducted in Tripoli in June 2012. In this study the interviews were conducted 'face to face' with all respondents. The interviewees were selected on the basis that they possessed the knowledge and the experience necessary that was relevant to contribute to the research objectives. At the beginning, interview appointments were arranged through telephone calls made to the respective persons. The researcher benefited from being an external auditor in Libya as a result of which personal relationships had been developed with some of the targeted interviewees. Once the researcher contacted those individuals and asked for an interview, they were willing to be interviewed and also recommend other

[58] On 15th Feb, 2011, uprising events started in Benghazi and spread out to all the other cities in Libya; this revolution concluded with a declaration ending the dictatorship era on 20th August 2011 (BBC, 2012a and b).

key persons that could be interviewed to gain more insightful information[59]. Interviewees have been divided into four groups namely: Preparers (PR); Auditors (AD); Regulators (RG); and Users (US). Some interviewees hold more than one position; for example, PR5 is a bank chairman, external auditor and academic. Table 6.2 presents the interviewees organised by group.

Table 6.2: Interviewee Groups

Group		Position	Qualification	Location
Preparers	**PR1**	Chairman	Msc	Commercial bank
	PR2	Head of Correspondent Banking Office	Msc	Commercial bank
	PR3	Member of BoD	PhD	Commercial bank
	PR4	Head of Accounting Dept.	Bsc	Commercial bank
	PR5	Chairman	PhD	Commercial bank
	PR6	Head of Accounts Preparing Dept.	Bsc	Commercial bank
	PR7	Head of Accounts Preparing Dept.	Bsc	Commercial bank
	PR8	Head of Correspondent Banking	Bsc	Commercial bank
	PR9	Vice Manager of Eastern Branches Management	Primary School	Commercial bank
	PR10	Head of Finance and Control	Msc	Commercial bank
	PR11	Head of Financial Management	Bsc	Commercial bank
	PR12	Assistant Manager of Accounting Dept.	Diploma	Commercial bank
Auditors	**AD1**	Auditor	Bsc	Audit firm
	AD2	Auditor	Msc	Audit firm
	AD3	Senior Partner	PhD	Audit firm
	AD4	Managing Partner	Bsc	Audit firm
Regulators	**RG1**	Chief of Benghazi Branch	Msc	LAAA
	RG2	Inspector of commercial banks	Bsc	CBL
	RG3	Inspector of commercial banks	Msc	CBL
	RG4	Banking Exchange Control Dept.	Bsc	CBL
	RG5	Governor Deputy of CBL (Benghazi branch)	Msc	CBL
	RG6	Vice General Manager	Bsc	Tax Authority
	RG7	Head of Listing and Follow-up Dept.	Bsc	LSM
	RG8	Head of Internal Audit	Bsc	LSM
	RG9	Manager of Surveillance & Follow-up Risks Dept.	Msc	LSM
	RG10	Legal Consultant	Bsc	Commercial bank
Users	**US1**	Lecturer	PhD	Benghazi Uni.
	US2	Lecturer	PhD	Benghazi Uni.

Note: This table shows the characteristics of the interviewees, PR= Preparer, RG= Regulator, AD= Auditor, US= Users.
BoD= Board of Directors, LAAA= the Libyan Accountants and Auditors Association, CBL= Central Bank of Libya, and LSM= Libyan Stock Market.

[59] Although the researcher benefited from the advantage of developed personal contacts, this situation had particular implications especially when auditors and high level employees (e.g. chairman) were interviewed. The former may consider the researcher as a competitor, hence giving sensitive information on the audit process they follow would be problematic, while the latter may consider the researcher a potential auditor of the firm.

All the interviews were recorded with the pre-permission of the interviewees. The interview recordings were later transcribed[60] and translated into English and then notable quotations were highlighted.

6.3 Interviewees' Perceptions about the Quality and Importance of Financial Reporting

The quality of financial reporting represents a core element of accountability between preparers and report users. As discussed in Chapter 4, accounting can be seen and understood from an accountability perspective which perceives, according to Ijiri (1983), that the accounting objective is to provide fair accounting information. In other words, accounting information should flow fairly from accountor to accountee. The fundamental objective of the accounting system within the accountability framework, as reported in Table 4.1, is fairness. Fair accounting information, according to Ijiri (1983), can be seen as that accounting information which is objective and verifiable. Being objective means that accounting information presented to an accountee is free from bias while verifiability means that "there are sufficient trails to enable anyone to reconstruct the information" (p. 75). Based on the above discussion, the accountability process has to be fulfilled in order to financial reporting be perceived as of high quality. Within the accountability framework, accounting information should be fairly presented and characterised as objective and reliable. In this study, the accountability process is taking place when high quality financial reporting is perceived as being obtained.

A number of economic consequences of firms issuing high quality financial information have been documented in the literature. For example, the costs of capital could be lowered if high quality financial information is provided. Also, capital would be more efficiently allocated in the financial market if high quality financial information is supplied (Soderstrom and Sun, 2007).

[60] Interviews were not fully transcribed but all significant parts as determined by the researcher were transcribed verbatim then translated.

To evaluate the quality of financial reporting, researchers have used the qualitative characteristics that are mentioned in the conceptual frameworks. In US GAAP, for example, McDaniel et al. (2002) evaluated the quality of reporting by using the features of the Financial Accounting Standard Board's conceptual framework that are contained in the Statement of Accounting Concept No. 2 Qualitative Characteristics of Accounting Information. Biddle et al. (2009) defined financial reporting quality as "the precision with which financial reporting conveys information about the firm's operations, in particular its expected cash flows, that inform equity investors" (p.113). This definition is in line with one of the stated financial reporting objectives of Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 1 (1978) , that is to provide current and potential investors with useful information to help them in making informed decisions (Biddle et al., 2009). Similarly, Chen et al. (2011) defined financial reporting quality as the "precision with which financial reporting conveys information about firms' operations" (p. 1256).

If one opted to use the IASB conceptual framework, the quality of financial reporting can be assessed by reference to whether useful financial information has been provided. To be useful, financial information must be relevant and faithfully representative. To enhance the relevance and faithful representation of useful financial information, another four qualitative characteristics have to be met so that financial information could be considered of high quality: comparability, verifiability, timeliness and understandability (IASB, 2010b). This study argues that providing financial information that is objective and verifiable to various stakeholders can be regarded as fulfilling accountability by the Libyan Commercial Bank managers. Moreover, for Libyan Commercial Bank managers to be accountable, they have to provide financial information that is relevant and faithfully representative. In other words, financial information has to be unbiased and free from management's intervention so that bank managers are perceived to be accountable. This study argues that in order for an LCB manager to be held accountable, he/she should act ethically by producing unbiased accounting information.

In this section interviewees were asked how they perceive the quality of financial reporting of the Libyan banking sector as well as the importance of financial reporting and for whom they consider it to be important. As mentioned earlier, production of high quality financial reporting would refer to objective and reliable accounting information which, according to this study, constitutes an accountability system.

6.3.1 The Quality of Financial Reporting

The first question asked the interviewees how they perceive the quality of financial reporting in Libya generally and in listed companies specifically. Interviewees expressed a variety of views about the quality of financial reporting that ranged from an inability to assess the quality, to a perception that financial reporting reflected a high degree of quality. Interviewee PR3, who is a member of the Board of Directors of one bank and who holds a PhD degree in financial management, replied to this question as follows:

> "The term quality is flexible; you don’t have standards to measure the quality. The question is not clear, there are no standards in Libya so how to assess the quality? Due to the absence of accounting standards one cannot assess the quality".

IASB pronouncements are implicitly required by the Central Bank of Libya[61] (CBL) for all commercial banks and explicitly by the Libyan Stock Market (LSM) for all listed companies which suggests that in order for Libyan Commercial Banks to be accountable to their shareholders, financial statements have to be prepared accordingly otherwise accountability would be impaired. Although IAS/IFRS are required by the LSM in preparing accounts, however they are typically still not yet applied in the researcher’s experience. The reason behind that, according to PR3, is related to lack of knowledge on

[61] Although reference to IAS/IFRS was not explicitly made in the CBL regulations, the term “international standards” has been interpreted by many as IAS/IFRS. In the experience of the researcher this is the general view taken by the commercial banks community and auditors.

how to apply IAS/IFRS. This interviewee challenged the researcher to find a person in Libya who understands IAS/IFRS.[62]

Financial reporting quality, according to RG8, could be measured by whether the financial statements are suitable for decision making; he answered this question by saying:

> "How to measure the quality? I would do that in respect of its usefulness for decision makers".

The lack of accounting standards, according to some interviewees might be the reason why financial quality in Libya is low with no difference being observed between listed and unlisted companies. AD3, for example, stated:

> "It is a big question. It is not a stock market issue rather than a general issue that applied to all companies operating in Libya which is the lack of accounting standards".

It could be said, according to this quotation, that either the issuance of local standards or adopting the international ones would improve the quality of financial reporting and thus accountability. One of the key qualitative characteristics identified in Table 4.1 that accounting information should have is stability which explicitly in such a case, lack of accounting standards, would be unreachable. However, the lack of accounting standards would also affect the objectivity and verifiability of accounting information.

Another interviewee RG9 agreed with this notion and commented on the quality of financial reporting by stating:

> "The financial reporting quality is very weak. Moreover, there is no difference in the quality between listed and unlisted companies because of no accounting standards. All we have is the broken record that is "according to GAAP" which we don't have any definition of so that we can be clear on what is meant when someone uses this expression. No one exactly knows what the term GAAP means. When you and I disagree we don't have any reference that we go to so we should have a written GAAP, no matter if even written on a cement bag. Thereby, the quality is zero due to no accounting standards".

[62] He was holding the huge book of IAS/IFRS while stating "you will never find anyone who understands this well even though they say according to IAS/IFRS, but the fact is, it is not according to IAS/IFRS".

However, it was expected that the LSM would have an influence over the quality of financial reporting and thus accountability. Therefore this unexpected assertion is worth noting as it is made by RG9 whose work location is the LSM which implies a reasonably wide knowledge about the financial reporting quality of listed companies. One could infer that the LSM has not improved the accountability of listed companies.

From the interviews, it appears that financial reporting in Libya is unduly dependent on management judgment and therefore subject to bias. Therefore, its quality tends to be not perceived as good and not perceived as neutral. Interviewee RG4 said of financial reporting quality that:

> "They [financial statements] are biased to management; managers do use these reports to appear as successful. They are not good on average".

This may suggest a conflict of interest between agents and principals which would have an adverse impact on financial reporting and accountability, given that managers would have managed the financial statements to, according to RG4, secure their jobs.

The accounting literature, according to interviewee US1, offers a solution for this question. The interviewee advised that Libyans should get back to the literature in order to assess the quality of financial reporting. He stated:

> "Literature has answered this question. It is not good at all and the evidence is that they [financial statements] are not used in the decision making process in Libya. I don't know why you ask this question. Investors base their decisions on dividends".

Interviewees' responses can be divided into two broad types according to two categories (Table 6.3); preparers and other stakeholders. 75% of the Preparers were satisfied with the quality of financial reporting and viewed it as good. On the other hand, most of the Other Stakeholders (about 88%) were dissatisfied with the financial reporting quality and perceived it to be less than satisfactory. The overall proportion of all interviewees who saw financial reporting quality as not good was 57%. The interview results suggest the reasons behind the perceived low quality of financial reporting of the Libyan Commercial Banks.

These relate to the lack of understandable accounting standards and unfaithful representation of financial information by managers, and as a consequence, financial information is not objectively presented. Table 6.3 provides a summary of interviewees' responses to Question 1. Based on these interviews' findings several perceptions were revealed: a lack of standards; the absence of local GAAP; the lack of knowledge on how to implement IAS/IFRS; and management bias. The overall view of 57% of stakeholders was that financial reporting quality was not good; the accountability system of the Libyan Commercial Banks can be said to be impaired.

Table 6.3: Interviewees' Reponses to Financial Reporting Quality Assessment

Interviewee	Q1: Assessment of quality	Aggregate
PR1	Good	75 % of preparers (9) view financial reporting quality is good, 8% unable to assess the quality and 17% see it not good.
PR2	Not good, "weak"	
PR3	Don't know "no standard to measure"	
PR4	Good	
PR5	Not good	
PR6	Good	
PR7	Good	
PR8	Good	
PR9	Good	
PR10	Good	
PR11	Good, "our bank's quality is high"	
PR12	Good	
AD1	Not good	100% of Auditors (4) regard the financial reporting quality as not good
AD2	Not good	
AD3	Not good	
AD4	Not good	
RG1	Not good	80% of Regulators (8) perceive the quality of financial reporting as being not good
RG2	Not good	
RG3	Good	
RG4	Not good	
RG5	Not good	
RG6	Don't know	
RG7	Not good	
RG8	Not good	
RG9	Not good	
RG10	Not good	
US1	Not good	100% of Users (2) see the financial reporting quality as not good
US2	Not good	
The overall average who view financial reporting good is 10 that is equal to 36 %		
The overall average who view financial reporting not good is 16, this is equal to 57%		
The overall average for those who don't know is 2 which are equal to 7%.		

Note: This table shows different perceptions of the stakeholders towards the quality of financial reporting of the Libyan commercial banks. The perceptions in this table are divided into four groups; Preparers, Auditors, Regulators, and Users.

The above table clearly suggests a disagreement between Preparers of financial statements who believe quality is 'good' and those who monitor the Preparers' activities (Auditors and Regulators) who perceive quality to be poor. This arguably reflects a lack of trust and confidence between the two groups.

6.3.2 The Importance of Financial Reporting

The link between accounting information and accountability has been outlined in the literature. Accounting information represents one of the vehicles by which accountability is discharged according to Niskala and Nasi (1995):

> "Accounting information is used for accountability purposes. It covers traditional stewardship accounting which requires the firm to demonstrate that it has accounted for its resources in an accurate way, has utilized resources only for legitimate purposes and has correctly maintained its assets" (p. 123).

Financial reporting is typically deemed of high importance to a wide range of users particularly investors. The second question (see Table 6.1) was to rate the importance of financial reporting and to whom it is important from the view point of interviewees. 97% of interviewees viewed financial reporting as important. The pervasive reason given was that it presents the financial position of the firm and informs decision making. It is also important for a wide range of stakeholders including owners, management, employees, investors and regulators. PR11 said that financial reporting is important in helping the owners in decision making. Obviously interviewees acknowledged the importance of being accountable to a wide range of stakeholders rather than only shareholders. Although this wider accountability concept will be discussed in detail later on when Q 7 (Table 6.1) is discussed, some interviewees addressed the wider notion of accountability in response to this earlier question about the importance of financial reporting by identifying stakeholders other than shareholders to whom financial reporting is important.

The importance of financial reporting was expressed and explained in a number of ways by interviewees. For instance, PR12 viewed the importance of financial reporting as very high since it shows the results of the company. He stated:

> "Financial reporting is highly important to the institution itself. It shows the profitability for the current year or in comparing to previous years. Also it is

important to shareholders and investors in that it influences the share price".

It was also suggested by AD3 that financial reporting is important and that this fact needs no evidence. He commented on this question by saying:

> "Needless to say it is important. It represents the summary of transactions and especially in Libya where there are no quarterly reports".

This view was also reflected in RG9's perspective who emphasised the importance of financial reporting by stating:

> "They [financial statements] are important because they show the financial position and situation of the company, there is no argument in that".

AD3 also added that the annual reports are most important as they are the only source of published information and thereby they are the only means by which accounting information can be obtained by external users. He added:

> "The financial statements are the only reports that are published. It is important to management, owners, the state, and tax authorities".

It is clear that some interviewees acknowledged the importance of financial reporting and one can therefore argue that, implicitly, the provision of accounting information, at least once a year, is seen to fulfil an important accountability function. Accountability can therefore be seen to be exercised even if perceptions of the quality of reporting suggest that, for some, there is scope for the accountability to be improved.

As mentioned earlier, some stakeholders other than shareholders have been addressed by some interviewees, which may suggest some awareness of the wider notion of accountability. RG3, for example, summarized his answer in which he particularly made reference to the banking sector by saying:

> "Sure it is important as it gives the real picture of the firm to the Libyan Stock Market (LSM), shareholders, employees and customers. It is important for the Central Bank of Libya (CBL), shareholders and society. The banking sector is very important".

Employees, according to RG9, should pay attention to the financial position of the company they work for. In his comment regarding for whom financial reporting is important, RG9 indicated that:

> "It is important to owners, creditors and employees. The latter have to be concerned about the financial position of the company they work for. They don't want to work for it until it collapses… anyone who deals with the company has to be interested in its financial position".

A summarized answer was given by RG7 who said:

> "They [financial statements] reflect the company's position and are important to all users".

The findings of the interviews reveal that a majority of the interviewees (97%) believe that financial reporting is important. In other words, most of the interviewees recognise the importance of issuing the annual reports as a way of discharging the accountability of bank managers. Given that only 36% (Table 6.3) of interviewees perceive the quality of financial reporting as good this would suggest that most interviewees acknowledge the importance of accountability in the Libyan Commercial Banks but also feel that accountability is far from being all it should be.

6.4 Interviewees' Perceptions about Earnings Management

There is widespread agreement amongst western accounting practitioners and academics that earnings management is pervasive and therefore widely known within both the academic and practitioner communities (Levitt, 1998; Loomis, 1999). This section examines the interviewees' awareness of the term 'earnings management'; specifically, interviewees were asked several questions (Questions 3,4,5,6,8,9,10, and11 in Table 6.1) in order to elicit their understandings and views about it. First of all, interviewees were asked whether they were familiar with the term and what they understood by this term. In cases where an interviewee had not heard of earnings management, the definition by Healy and Wahlan (1999) was used to explain what is meant by the term in order to have meaningful answers for the remaining questions. Earnings management, according to Healy and Wahlan (1999), occurs when:

> "… managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company, or to influence contractual outcomes that depend on reported accounting numbers" (p. 368).

Afterwards, the interviewees were asked about the existence of earnings management in Libya generally and within the banking sector specifically. They were also asked about the motivation for and any constraints on earnings management. Finally interviewees were asked to determine whether the practice of earnings management is seen as ethical or unethical.

6.4.1 Earnings Management Awareness

Interview findings show that 79% (22) of the interviewees had not heard about the term "earnings management". Table 6.4 summarises the answers to this question (Q3, Table 6.1).

Table 6.4: Interviewees' Responses about Familiarity with the term "Earnings Management"

<table>
<tr><th>Interviewee</th><th>Q1: Are you familiar with the term "Earnings Management"</th><th>Aggregate</th></tr>
<tr><td>PR1</td><td>No</td><td rowspan="12">9 of preparers (75%) have not heard of the term.</td></tr>
<tr><td>PR2</td><td>No</td></tr>
<tr><td>PR3</td><td>Yes "I haven't yet seen a department for it"</td></tr>
<tr><td>PR4</td><td>Yes</td></tr>
<tr><td>PR5</td><td>Yes</td></tr>
<tr><td>PR6</td><td>No</td></tr>
<tr><td>PR7</td><td>No</td></tr>
<tr><td>PR8</td><td>No</td></tr>
<tr><td>PR9</td><td>No</td></tr>
<tr><td>PR10</td><td>No</td></tr>
<tr><td>PR11</td><td>No</td></tr>
<tr><td>PR12</td><td>No</td></tr>
<tr><td>AD1</td><td>No</td><td rowspan="4">4 of auditors (100%) have not heard of the term.</td></tr>
<tr><td>AD2</td><td>No</td></tr>
<tr><td>AD3</td><td>No</td></tr>
<tr><td>AD4</td><td>No</td></tr>
<tr><td>RG1</td><td>No "this term is not in circulation"</td><td rowspan="10">8 of Regulators (80%) said that they have not heard about the term.</td></tr>
<tr><td>RG2</td><td>Yes</td></tr>
<tr><td>RG3</td><td>No</td></tr>
<tr><td>RG4</td><td>No</td></tr>
<tr><td>RG5</td><td>No</td></tr>
<tr><td>RG6</td><td>No</td></tr>
<tr><td>RG7</td><td>No</td></tr>
<tr><td>RG8</td><td>No</td></tr>
<tr><td>RG9</td><td>Yes</td></tr>
<tr><td>RG10</td><td>No</td></tr>
<tr><td>US1</td><td>Yes</td><td rowspan="2">Only one User (50%) has not heard of the term</td></tr>
<tr><td>US2</td><td>No</td></tr>
<tr><td colspan="3">The aggregate number of interviewees who have not heard about the term is 22 representing 79% of all the interviewees.</td></tr>
</table>

Note: this table summarises the interviewees' awareness of the term "earnings management", the answer "yes" means that interviewee has heard of the term, while "no" means otherwise. The perceptions in this table are divided into four groups; Preparers, Auditors, Regulators, and Users.

Then, interviewees were asked what they understood by the term "earnings management" (Q4, Table 6.1); seemingly interviewees were drawn to a literal translation as most of the responses revolved around how to create and invest the earned profits through a specific department, (in other words they thought it referred to allocating and investing earnings that had been achieved). It is worth mentioning that some of the respondents, for instance, PR3 and RG2 who asserted that they had heard of the term, actually referred to the same meaning, that is, a department for creating and investing earned profits. Table 6.5 shows how interviewees interpreted the term "earnings management". As the findings suggest, only five of the 28 executives interviewed identified earnings management as a manipulative behaviour to manage the earnings figure.

Although the Arabic translation used in this study is literal, same translation has been used in several Arabic studies on earnings management e.g. Issa (2008), Hamdan and Abo-Ijila (2012), and Al-Sartawi et al. (2013).

Table 6.5: The meanings attributed to the term "Earnings Management"

Interviewee	Q4: What do you understand by the term "Earnings Management"	Aggregate
PR1	Managing the work to create profits	9 of Preparers (75%) interpret earnings management as a department for monitoring profits or as how to invest the earned profits.
PR2	Investing earned profit	
PR3	A department for monitoring the profit	
PR4	Result of transaction	
PR5	**Over/understating the profit**	
PR6	Managing the achieved earnings	
PR7	Investing earnings	
PR8	Investing profits	
PR9	Reusing the earned profit	
PR10	Distributing earnings to shareholders or invest profit	
PR11	A dedicated dept. for following up profits	
PR12	Investing earned profits	
AD1	**Required procedures to achieve targeted earnings**	50% of Auditors viewed earnings management as being earnings manipulation
AD2	A dept. that studies a firm's earnings	
AD3	**Benefiting or manipulating the earnings in a manner that fits to preparers**	
AD4	The sum one has earned and what was the targeted bottom line	
RG1	Using the profits	8 out of 10 Regulators consider earnings management as to invest the earned profits
RG2	Reusing the earnings	
RG3	A dept. to invest the profits	
RG4	A dept. to increase the profits	
RG5	Investing the net income	
RG6	The proper use of income	
RG7	Investing the realised profits	
RG8	A dept. for managing and controlling the profits	
RG9	**Earnings manipulation**	
RG10	Investing and managing the achieved earnings	
US1	**A managerial behaviour to smooth income**	Only one User (50%) recognised earnings management
US2	Reinvesting the profits	
Only five interviewees representing 17.8% have interpreted the meaning of "Earnings Management" as a manipulative behaviour.		

Note: this table shows how interviewees have interpreted the term earnings management. The perceptions in this table are divided into four groups; Preparers, Auditors, Regulators, and Users.

For example, PR1 who is a commercial bank chairman, holding a masters degree in accounting, commented:

> "I think it means how to create profit and how to manage the work so as to achieve more profits".

Interviewee, PR10, saw earnings management as meaning distributing the earnings to shareholders. Another interviewee, PR11, went further in describing the meaning of earnings management by saying:

> "The term refers to a dedicated department that is mainly responsible for following up and improving the company's profits".

Interviewee RG4 supported these ideas by saying:

> "The term means establishing a department to invest the realised profits".

It appears that the problem in misunderstanding is with the word "management" since most of the interviewees are employees for whom such a word has only one meaning.

The word “management” seems to have an impact on the meanings of the term “earnings management” as understood by some interviewees, for example, RG8 indicated:

> "Management means a management that plans and controls activities. Earnings management then is management that is concerned with planning and controlling the earnings in terms of retaining control of revenues and focusing on profitable activities".

Interview findings also suggest that the term "earnings management" itself might be the reason for it not being known and understood in its conventional sense. The Arabic translation[63] of earnings management may be interpreted as referring to a department which has responsibility for monitoring and controlling of earnings. When the definition, according to Healy and Whalan (1999) was offered to interviewees they readily identified the meaning of earnings manipulation. (RG1) stated:

> "This term is not in circulation… by this, the term refers to the disposal or use of the profit. I think it is a matter of translation. The term earnings manipulation should instead be used".

Similarly, (RG6) suggests:

> "At the first glance, I understand it as the proper use for income. I think the name is a little strange, might be the translation".

[63] The literal Arabic translation of earnings management (Edaret Al-arbah) has been interpreted as the unit or department in which earnings were planned, controlled and managed.

Earnings management, as a term, is widely unknown[64] amongst the interviewees, across all stakeholders groups. However, it is believed that this practice does exist in Libya. In this vein, PR5 suggests:

> "I have not seen any research asserting that earnings management does exist in Libya, but based on accounting policies for depreciation, inventory and tax purposes which give some margin to manager so I would expect it to occur".

Interviewees were also asked to indicate to what extent they think earnings management is practiced in Libya generally (Table 6.1, Q5). Perceptions about whether earnings management is practiced by Libyan companies generated a mix of views. Some believe that earnings management does really exist while others believe otherwise. The interviewees' responses to this question are summarised in Table 6.6.

[64] Based on the evidence of these interviewees, I would speculate that, if earnings management were to become more widely known it may be translated "earnings manipulation" rather than be given a literal translation.

Table 6.6: The Scope of Earning Management Practices by Libyan Corporations

Interviewee	Q5: Is earnings management practiced in Libya	Aggregate
PR1	No	58% (7) of preparers think that earnings management is not practiced by Libyan corporations
PR2	Yes	
PR3	Yes	
PR4	No	
PR5	Yes	
PR6	No	
PR7	Yes	
PR8	No	
PR9	No	
PR10	Yes	
PR11	No	
PR12	No	
AD1	Yes	75% of auditors believe earnings management does exist within Libyan corporations
AD2	No	
AD3	Yes	
AD4	Yes	
RG1	Yes	60% of regulators confirm that earnings management is exercised by Libyan corporations
RG2	No	
RG3	Yes	
RG4	Yes	
RG5	Don't know	
RG6	No	
RG7	Yes	
RG8	Yes	
RG9	Yes	
RG10	Don't know	
US1	Yes	50% of users think earnings management is practiced by Libyan corporations
US2	Don't know	
The overall average of who believe that earnings management is practiced by Libyan corporations total to 15 interviewees giving the overall percentage of 53.5%. The overall average of who believe that earnings management is not practiced by Libyan corporations is 10 which equals to 35.7%. The remaining offered no answer.		

Note: this table summarises the interviewees' perceptions regarding the practice of earnings management by Libyan corporations. The table differentiates between the different stakeholders based on four main groups; Preparers, Regulators, Auditors, and Users.

The results reported above may have significant implications regarding the accountability of Libyan corporations. Given that the prevalence of earnings management may be related to the existence of low quality financial reporting, it can imply a relatively weak accountability process. Given that 53.5% of interviewees think that Libyan corporations are engaged in earnings management practices, one may judge that accountability is widely seen to be impaired for this reason.

More specifically, Q 6 (Table 6.1) investigates interviewees' perceptions about the practice of earnings management by the Libyan Commercial Banks and, if it did occur, how management would or could alter the reported income. Eight preparers out of 12 believe that earnings management is not practiced by the Libyan Commercial Banks while 11 stakeholders think that earnings management is strongly practiced in the Libyan Commercial Banks. Table 6.7 summaries these responses.

Table: 6.7: The Scope of Earnings Management Practices in the Libyan Commercial Banks

Interviewee	Q6: Is earnings management practiced within the LCBs	Aggregate
PR1	No	Only 4 Preparers out of 12 (33%) believe earnings management is practiced in the Libyan Commercial Banks
PR2	Yes	
PR3	Yes	
PR4	No	
PR5	No	
PR6	No	
PR7	Yes	
PR8	No	
PR9	No	
PR10	Yes	
PR11	No	
PR12	No	
AD1	No	2 Auditors out of 4 (50%) think that earnings management is practiced by Libyan Commercial Banks
AD2	No	
AD3	Yes	
AD4	Yes	
RG1	Yes	8 Regulators out 10 (89%) believe that Libyan Commercial Banks are engaged in earnings management practices
RG2	Yes	
RG3	Yes	
RG4	Yes	
RG5	Yes	
RG6	No	
RG7	Yes	
RG8	Yes	
RG9	Yes	
RG10	Don’t know	
US1	Yes	1 (50%) of Users believes that earnings management is practiced within LCBs
US2	Don’t know	
The overall average of who believe that earnings management is practiced within Libyan Commercial Banks total to 15 interviewees giving the overall percentage of 53.5%.		

Note: this table summarises the perceptions of interviewees regarding the engagements of the Libyan Commercial Banks in the earnings management practices. The table differentiates between the different stakeholders based on four main groups; Preparers, Regulators, Auditors, and Users.

RG9 commented on whether banks manage their earnings by saying:

> "Yes, because the available standards[65] give the chance for managers to intervene in the reported income. For example, they can maximise the provision; who can say “no”. I am personally convinced that banks do

[65] Although there are no local standards so far, practitioners usually refer to the current accounting practices as local standards.

manage their earnings as they use huge provisions and no bank had incurred a loss, how come? Surly they have managed their earnings".

Notably, regulators believe that earnings management is practiced by LCBs unlike most of the preparers. For example, RG1 suggested that LCBs, to large extent, are manipulating their income. In his response to the question about whether he thinks earnings management is practiced in the Libyan banking sector, his answer came as follows:

> "Yes they do, banks do manipulate earnings to large extent".

In the same vein, RG4 believes that effectively all Libyan Commercial Banks are involved in earnings management. He said:

> "Yes almost all banks practice it [earnings management]".

PR12, who does not believe that earnings management is practiced by LCBs, offered the statement below during his interview[66]:

> "Last year (2011[67]) we incurred a loss while another commercial bank has booked net profit of 200m LD which in fact is not real. 2011 was the year of revolution and there was an economic recession in which the loan provision should be calculated for those loans that have not moved during the year and of course there was no movement on those loans which makes them, according to central bank regulations, regarded as bad loans and thereby proper provision should be calculated which has not happened with that bank. And instead they have calculated the interest and have not made any provisions".

The continual process of reporting positive results (income) by the LCBs arguably represents, according to AD4, a strong piece of evidence that these banks are managing their income, AD4 considers this process of commercial banks as evidence of managing earnings, he commented:

> "Yes, I think they [banks] try to have their results positive [profits]. The evidence from reporting is that there is no bank incurred loss".

The findings of the interviews suggests that a distrust exists between preparers and non-preparers stakeholders, as 67% of preparers assert that Libyan commercial banks are not

[66] While his quotation clearly suggests that earnings management does exist within local banks, his answer was extremely opposite by saying that the practice does not exist. Obviously he was defending his bank's reputation given that he is the chief accountant there, as noticed by the researcher.

[67] The year 2011 was exceptional as witnessed the revolution of 17th Feb where there was no activities and almost all industries have been affected. It is expected to see banks reporting losses in such circumstances given no income.

engaged in earnings management practices while 69% of non-preparer stakeholders believe that earrings management is widely practiced by the Libyan Commercial Banks. This, again, arguably reflects a lack of trust between the preparers and other stakeholders as suggested when the quality of financial reporting was discussed above.

As discussed earlier, there is a strongly held belief amongst non-preparer stakeholders, that earnings management is widely exercised in LCBs as shown in Table 6.7. The findings of this question are in line with what may be expected according to their positions. Preparers who can be regarded as agents, may be expected to defend the quality of financial reporting and to declare that these reports are free from bias. In other words, the financial reporting according to them may be subjective though not biased by management. Therefore, management can be accountable to the principal by providing them with subjective accounting information. On the other hand, other groups' perceptions are different. The majority of Regulators believe that earnings management is practiced by the LCBs, while only half of interviewed Auditors have expressed the view that this practice exists, (although it was only a small sample of 4 auditors) and one of them (AD1) had not actually engaged in auditing any commercial banks at the time of the interview. Also, the interview with AD2 took place in the commercial bank premises where he is the auditor which to some extent may have affected his answer towards such issues. In the Users group, only one (of two) agreed with the view that earnings management is practiced. The overall findings reveal, in addition to the distrust issue, perceptions of a lack of legislation so that accountability can be effectively performed. It has been noticed that the absence of (formalised) local accounting standards may give the opportunity for bank managers to indulge in earnings management practices[68] which may lead to a breach in the accountability relationship.

[68] However, earnings management could be practiced even with exist of accounting standards.

Interviewees were also asked to determine who they regard as the main stakeholders in banks. Owners, management, investors, the Libyan Stock Market (LSM), the Central Bank of Libya (CBL)[69], and the tax authority came in as the most common responses. Interviewees' responses to this question are summarised in Table 6.8.

Table 6.8: The Main Stakeholder of a Libyan Commercial Bank as Determined by Interviewees

Interviewee	Q7: Who do you regard as the main stakeholders in banks?	Aggregate
PR1	LSM, investors and correspondents banks	10 of Preparers (83%) perceive shareholders to be the main stakeholder to the LCBs.
PR2	Shareholders	
PR3	Shareholders	
PR4	CBL and LSM	
PR5	Shareholders	
PR6	Shareholders and employees	
PR7	The state as the owner	
PR8	Shareholders, management, tax and CBL	
PR9	Shareholders	
PR10	Shareholders, customers and employees	
PR11	Big shareholders and big customers	
PR12	Shareholders	
AD1	Shareholders	3 of Auditors (75%) see shareholders as the main stakeholder of LCBs
AD2	Major shareholders	
AD3	Owners, CBL, management and Tax.	
AD4	CBL	
RG1	CBL, shareholders, tax and investors	7 of Preparers (70%) view shareholders as the main stakeholders for LCBs
RG2	Shareholders for private banks and CBL for state banks	
RG3	CBL	
RG4	Shareholders, CBL and investors	
RG5	Shareholders	
RG6	Shareholders	
RG7	Shareholders and investors	
RG8	CBL and investors	
RG9	Shareholders and CBL	
LG1	Don't know	
US1	Customers	1 of Users (50%) regard shareholders as being the main stakeholder
US2	CBL and shareholders	
75% of interviewees perceive the shareholders as the main stakeholders for LCBs.		

Note: This table articulates the interviewees' perceptions regarding who is the main stakeholder to the Libyan Commercial Banks.

The interview findings suggest that shareholders are perceived to be the main stakeholder in Libyan Commercial Banks. It can be noticed that accountability is, in that case, only seen in its narrow notion that bank managers are only accountable to shareholders.

[69] It is worth mentioning that the CBL is the owner of the state banks, so when it is mentioned it would not be clear if it was being regarded as a regulator or as an owner, or both.

However, the wider notion of accountability was touched on by some interviewees as discussed earlier. For example, US1 perceives owners as not being the main stakeholder in LCBs. He regarded banks' customers as the main stakeholder. He stated:

> "The main stakeholder in my opinion is not the shareholder. The Bank of Commerce and Development[70], for instance, has a total capital of 50m LD while the available resources for the bank are about 2b LD. However, when the bank collapsed, it is clients who will suffer more than shareholders. Theoretically the main stakeholder is the shareholder but practically it is the customer. If the bank had gone bankrupt the customers would lose much more than shareholders; this is the case in Libya".

In addition to shareholders and customers, employees are also considered as stakeholders in LCBs. PR10 stated:

> "The main parties who affect or are affected by a bank are shareholders either private or state, customers who might suffer in case of bank default, and employees. At the end of the year employees will [implicitly] decide to continue to work for the bank with the same salaries, they are also interested because there might be compensation based on the reported income".

Major customers may take their money away if they feel that the financial position of the bank is below a secure level. PR11 views the main stakeholders in banks as:

> "Major shareholders and customers given the fact that their cash is in the bank. They [customers] are concerned about the liquidity of the bank and want to make sure that a bank at all the times is able to pay what they owe… if they feel that the financial position is poor they will remove their money".

RG9 stressed the importance of financial reporting to employees and indicated that employees have to monitor the financial position of the company they work for. This, according to RG9, would help them to decide whether to stay at the company or leave before it collapsed.

The previous quotations clearly suggest that some interviewees regarded management responsibilities as extending beyond the shareholders. In other words, the wider notion of accountability is considered as an appropriate approach from the point view of some interviewees. Given the wide group of stakeholders in commercial banks in general potentially including the whole of society, and given that Libyan banks are not exceptional

[70] A private bank operating in Libya.

in that respect, Libyan Commercial Banks could be understood only be regarded as owing some responsibility to a very wide group. Many stakeholders other than shareholders (e.g. clients, employees, and wider society) could be affected by the collapse of a commercial bank; therefore, for Libyan commercial banks the importance of effective accountability clearly follows.

The accounting literature suggests that the loan loss provision (LLP) is a vehicle that can readily be used for earnings management. The next question (Q8, Table 6.1) sought to explore what tools could be used to affect the reported income of LCBs. Interviewees were asked to specify any techniques they are aware of that could be used by LCBs to manage earnings. Table 6.9 summarises the interviewees' responses in regard to these questions.

Table 6.9: The Used Earnings Management Tools by LCBs

Interviewee	Q8: Are you aware of any techniques that may be used ot manage earnings in banks?	Aggregate
PR1	Reduce expenses and forward allowances	9 Preparers (75%) believed that LLP could be used to manage LCBs' income
PR2	Reduce expenses and LLP.	
PR3	Reduce expenses and LLP	
PR4	Result can't be changed[71]	
PR5	LLP	
PR6	No way to alter the result	
PR7	Provisions in general i.e. LLP	
PR8	Provisions i.e. LLP	
PR9	No use for such tools	
PR10	Reduce expenses and LLP	
PR11	LLP	
PR12	Set-aside interest and provision e.g. LLP	
AD1	LCBs earnings are not managed	2 Auditors (50%) think that LLP is the way how LCBs manage their earnings
AD2	Don't know	
AD3	Provisions e.g. LLP	
AD4	Provisions and set-aside interest	
RG1	LLP, investment impairment and depreciation	6 Regulators (60%) view LLP as used by LCBs for earnings management
RG2	Allowances e.g. LLP	
RG3	Reducing expenses and revenue recognition	
RG4	LLP	
RG5	Provisions in general and LLP in particular	
RG6	Not managed	
RG7	Don't know	
RG8	Provisions e.g. LLP	
RG9	Provisioned e.g. LLP	
RG10	Don't know	
US1	LLP and exchange rate	1 Users (50%) believes that LLP to be used by LCBs for earnings management
US2	Don't know	
64% of interviewees perceive the LLP as being used by LCBs for earnings management.		

Note: this Table shows interviewees' perceptions regarding how LCBs could manage their earnings. Most of interviewees volunteered to mention LLP as a technique to manage earnings, however the researcher in a very limited occasion prompted interviewee to such a technique.

Most of the interviewees' answers revolved around LLPs. AD3, for example, said:

> "Through the provisions, especially in banks as the main factor in any bank's accounts is provisions. There is a criterion on how to calculate the LLP regulated by CBL but it is a bit long and difficult to apply and there are always subjective points which we, as auditors, are facing. Managers are always trying to justify the way they did the calculation".

One of the Preparers, PR7, who is the chief accountant of a commercial bank and had 11 years of experience in preparing the financial statements of the bank, and who is one of the few preparers who thought earnings management occurs in the LCBs, answered this question, about how earnings management could be implemented, as follows:

[71] This interviewee is convinced that LCBs are not engaged in earnings management practices.

> "By using the provisions, management have only provisions to do so. For example, the evaluation of foreign currency rate of exchange provision as well as the LLP. Due to the weak system that we have, the accurate calculation of the latter can be an issue as it could not be accurately calculated due to the weak system we use… when I was a member of the LLP committee; I happened to receive a telephone call from our chairman asking for a certain figure to be stated as the LLP that year".

Also another way to manipulate the reported earnings could be by ignoring the booking of some expenses due or accruals. PR10 argued that this is a legal way to alter the reported income. He said:

> "An example for a legal way to lessen the expenses might be the dealing with those expenses that neither booked nor yet bank is asked to pay it. A bank may wish not to show such expenses in accounts as long as it is not yet required to pay it".

PR11, who does not believe that earnings management is practiced by LCBs, supported the idea of not booking some accruals or unpaid invoices as long as the provider has not asked for his money. His response was:

> "Accrual expenses may also be used to manage earnings. For instance, if you did not receive the invoice you may not book it. LLP represents the big item in the bank's accounts and despite the restricted procedures imposed by the CBL there is still a space for discretion".

Regardless of the use of LLP for earnings management, interviewees mentioned other ways that can be, or actually are, used by bank managers to manage earnings; for example, ignoring the booking of dues as suggested by PR10 and PR11. Although they clearly stated that it was a legal way to manage earnings, it is obviously a contravention of any GAAP to ignore the booking of incurred current period expenses. Based on such quotations one may argue that not only is earnings management practiced in the LCBs but also they may commit fraud by omitting financial transactions[72]. This would aggressively harm the accountability mechanism as it would produce not only biased information but further it gives a financial position that is certainly not faithfully represented.

[72] It is worth noting here the differing definition of earnings management in both UK and US contexts reported in Chapter 3. Earnings management, within the UK context, would be between the limits of GAAP whereas in the US context is both within and outside the GAAP.

According, to the CBL regulations, a provision is calculated as the difference between a debt that has gone bad and 80% of the warranty that was given as a guarantee. For example, if a debt equal to 1000 LD that is classified as a bad debt and the warranty given by the client is worth exactly 1000 LD. In this case the bank will have to make a provision of 200 LD being the difference between the deteriorated debt that is 1000 LD and the 80% of the warranty which amounts to 800 LD. PR11 suggests that this warranty might be re-evaluated so as to lessen or cancel the provision calculation. He commented:

> "They might re-evaluate the assets and loans. Re-evaluation of the loan warranties as, according to CBL regulations and procedures, we have to calculate 80% of the warranty given to cover the loan. If this percentage equals or exceeds the debt then no need for any provision. In return, if this percentage was under the debt we will make a provision for the difference. For example, a loan total to 1m LD with a warranty worth 1m LD when this client faces difficulties we will need to make a provision of 200,000 LD being the difference between 80% of the warranty and the original loan amount. We might resort to re-evaluate that warranty as it might be worth more than 1m LD say for example, 1.4m LD so we would not need to make any provision. The calculation of debt provision is done under the supervision of external auditors and the CBL. When I calculate the provision I tend to raise it rather than lower it in order to support the financial position of the bank".

In addition to the re-evaluation of the warranties, managers may contact some deteriorating clients asking them to pay in some money so that the manager would be able to change the client's classification and thereby avoid a need for a provision calculation. RG4 referred to this method. He said:

> "They mainly use the LLP. They can change the classification of some debtors so as the allowance would be decreased. They also may contact some debtors asking them to make some deposits in their accounts in order to mobilize the accounts thus the debtor classification would easily be changed from bad to good debt".

Banks also may use “set-aside interests” for earnings management. When a client faces any difficulties in paying the interest, a loan will be classified as a bad debt; interest is calculated and booked as a set-aside interest provision[73]. However, this technique could be illegal, PR12 has indicated:

> "They can use the set-aside profits [interest] to increase the current year income or they may save some revenue for next year. Set-aside profits are those revenues on deteriorating debts that have been calculated but not booked as revenues. Also, provisions might be used… provision for loan and provision for lawsuits against the bank. These provisions could be used to modify the appearance of the financial position".

Beside set-aside interests provision, managers may tend to calculate interest for the off-interest periods. Some loans may have the first year interest-free and the borrower is then only asked to pay interest starting from the second year. RG2 mentioned that banks may ignore this procedure and calculate and include the interest in the first year accounts. He stated:

> "They might use the previous allowances to boost earnings. Also, sometimes they calculate interest during the off-interest period. They might also expand or reduce expenses. For example, last year a bank realised 10m LD profits and would like to make them 12m next year since the beginning of the next year they will monitor the expenses. They misuse the circular of CBL regarding the LLP. This circular is not correctly applied. It depends on who's in charge ethics".

Simply, current year revenues are those revenues incurred in the year. RG3 mentioned that some banks go beyond the current year to use the next period's interest in order to boost current year earnings. This procedure was described as having been implemented by a foreign partner at one of the banks that has strategic participation with foreign investors. He indicated that:

> "Most banks try to raise income through reducing the expenses and including deferred revenues [interest]. Once of the commercial banks has applied this practice through the strategy partner [foreign management]; the case was to include the interest of the coming two years into the current year and justify it [on the ground] that the client is credible and that they have changed the base from cash to accrual".

[73] A set-aside interest provision includes the calculated interest for bad loans and is converted into revenues whenever a loan is reclassified as a good loan. The notion behind this is to not recognise revenues on bad loans.

Another problem with bank loans had been raised during an interview as some banks have very old loans that go back 40 years. During the last regime all commercial activities were nationalised. RG9 consider this problem as a loophole for earnings management. He said:

> "The provisions. You have had old loans for 40 years and they still appear in accounts and a lot of these loans are those which have been nationalized during the last regime but the original debts have not been transferred to the state. They remain on the names of the original clients".

The majority of interviewees were of the view that LLP is mainly used by LCBs for earnings management. Other ways have also been indicated as tools for managing the reported income i.e. reducing expenses through not booking them. Although this could be motivated in order to manage earnings (and may be regarded as such), it clearly strays beyond the accounting standards on the side of fraud. The fact that LCBs' financial reporting is regarded as being managed, however it is done, reveals that LCBs' accounting information included in their financial statements are regarded as biased. In other words, the accountability mechanism is regarded as being extremely compromised by LCBs' managers who, based on interview findings, are perceived to be highly engaged in earnings management practices and therefore providing biased accounting information. In fact the view of this research, based on the views of, and the evidence presented by the interviewees, earnings management is not only assumed to be done, but is actually carried out. Therefore, both regulators and users should have to look for some ways to restrict management freedom but in ways not to harm the flexibility needed for the exercise of professional judgement so in order to protect the quality of financial reporting. The next section is addresses the constraints that might be effective in mitigating the practice of earrings management by LCBs.

6.4.2 Earnings Management Constraints

This section considers the responses of interviewees to the question of what could affect the earnings management practice (Q9, Table 6.1); in fact the interviews showed many factors that might reduce the earnings management practices. For example, AD4 suggested two broad categories of factors that would help in mitigating the earnings management practice. He said:

> "Two main factors; External and internal. The external is CBL which has the supervision power. The internal is the internal control system and internal audit of the bank".

Another suggestion was offered by PR8 who suggested that enhancing the effectiveness of internal and external auditors would be one of the methods that could prevent or mitigate the practice of earnings management. He commented:

> "Weak internal and external audit would allow this practice".

PR11 also stressed the role of regulators in facing these issues. He stated:

> "The regulatory bodies, for example the central bank and external auditors as well as internal auditors [are important].

He also referred to the tax authorities:

> “When you minimise the expenses it sound good with them but if you maximise expenses they will try to stop it".

RG8 stated that regulators and auditors have to be taught about such issues so that they can affect the practice of earnings management. He said:

> "The knowledge and awareness of regulators and external auditors play a crucial role in mitigating it".

As discussed above, the lack of accounting standards has been blamed for low quality in financial reporting which might be associated with earnings management. Applying accounting standards would play a significant role, according to AD3, in affecting the earnings management behaviour. He stated that what was needed was:

> "…accounting standards that clearly show how to account for revenues and how to apply recognition. Also, making the provisions calculation process clear and simple in a way that is easy to apply being that loans provision is the core business for banks".

RG9 also supported the notion that accounting standards have a principal role in mitigating the practice of earnings management. He stated:

> "First of all, there should be accounting standards that are clear and able to remedy the issue along with the supervision over the companies for example by the CBL and the LSM".

Also AD1 considered the importance of accounting standards in constraining earnings management practice, as well as the CBL, and the internal and external auditors. He also mentioned that lack of professional management would have an influence on earnings management activities. He summed up what was needed as follows:

> "The presence of accounting standards that are applicable, internal and external control including the CBL and auditors, and finally professional management".

The interviewees suggested a number of ways in order to improve the quality of financial reporting by preventing or mitigating the practice of earnings management. For example, strengthening the effectiveness of both internal and external audit would have a positive impact. Also, the role of oversight from the CBL has been stressed as being potentially very influential, and the issuance of formal local accounting standards or adopting the IFRS was suggested. Based on the interview findings it could be said that the accountability process is seriously affected by the weakness of monitoring bodies; and of external and internal audit as well as by the absence of accounting standards. In order to protect accountees' rights and sustain a fair accounting system that provides fair accounting information available to all accountees, such monitoring bodies should be improved. For example, efficiency of the external audit function is said to provide credibility to financial information and therefore it should be less biased. In other words, more objective accounting information should be obtained with the existence of an efficient audit function.

Deficiencies in education can also be viewed as having an adverse impact on accountability.

Moreover it was suggested that supporting credit risk management may have an important role in mitigating the practice of earnings management. PR10 commented on this issue and also mentioned that IFRS could be a solution. He recommended:

"Applying the accounting standards or IFRS and activate the credit risk management".

6.4.3 Earnings Management Motivations

This section of the interviews was pursued to ascertain the views of interviewees regarding what motivates a bank's management to engage in earnings management practices. Table 6.10 briefly summarises earnings management motivation as perceived by interviewees.

Table 6.10: Earnings Management Motivation in the Libyan Commercial Banks

Interviewee	Q8: What do LCBs use to manage earnings?	Aggregate
PR1	To make dividends to shareholders	5 of Preparers (42%) consider job security as an earnings management motivation for LCBs
PR2	Competition with other banks	
PR3	To satisfy shareholders	
PR4	Satisfy shareholders, support financial position and compete with others	
PR5	Job security, influence stock price and management compensation	
PR6	To improve figures when a bank is facing poor results	
PR7	Job security and to obtain praise	
PR8	Did not answer question	
PR9	Did not answer question	
PR10	Job security	
PR11	Job security	
PR12	Job security	
AD1	To improve the firm	3 Auditors (75%) view dividends to shareholders as being earnings management motivation for LCBs
AD2	To pay dividends	
AD3	Showing success, dividends	
AD4	Satisfy shareholders through dividends	
RG1	Job security	8 Regulators (80%) regard job security as an earnings management motivation for LCBs
RG2	Job security	
RG3	To pay employees' dividends that recently took place in public sector	
RG4	Job security and ability to pay dividends	
RG5	Job security	
RG6	Job security, ability to pay dividends and paying less tax	
RG7	Management compensation and job security	
RG8	Job security and building up personal reputation and glory	
RG9	Job security	
R10	Cover losses, accounting problems and to satisfy shareholders by dividends	
US1	Cover up corruption, management compensation and job security	2 Users (100%) perceive job security as being a motivation to manage the reported earnings by LCBs
US2	Job security and pressures from board of directors	
The overall average for 'job security' is 50%.		
The overall average for 'dividends payments' is 25%		

Note: this table shows the interviewees' perceptions about the earnings management motivations in LCBs..

Apparently half the Preparers who answered this question identified job security as the main motivation for management to manage earnings. Eight of the 10 Regulators agreed with this perception. However, the Auditors generally perceived that earnings were managed in order to satisfy shareholders and show the firm in a favourable light. This is in line with the earnings management literature (e.g. Norohna et al., 2008) which suggests job security as one of the earnings management motivations. AD4 offered the following statement:

> "A number of reasons, the principal one is to satisfy the shareholders, management always try to have a fixed rate of distributions".

PR5 for example, expressed the following view:

> "Firstly, it is a personal matter, for managers that is to renew the assignment. Secondly, with the existence of the Libyan Stock Market, to increase the share price. Thirdly, sometimes a manager would receive a bonus that is tied to the net income".

PR12 made the following statement:

> "The reason is to improve the image of the management as seen by concerned parties for example the Central Bank of Libya[74] and to extend the length of the management assignment[75]".

Earnings management motivations might differ based on whether a bank is public or private and either a national or a foreign company. RG1 who earlier suggested the term earnings manipulation[76] differentiated between public, private and foreign companies and made the following observation:

> "Earnings manipulation is basically practiced for the reasons of increasing the profits in public sector companies including banks in order to burnish the Board of Directors' picture so as to secure the renewal of the assignment. In the private sector, banks' profits are increased to speed up capital recovery by which eventually the Board of Directors will be renewed for another period. And for family and foreign companies the direction is to understate the profit to pay less tax".

Earnings management, according to some views, is practiced to improve management's picture[77] in the eyes of the owners. This can be achieved, according to the majority of

[74] The CBL in this quotation is regarded as the owner (state bank).
[75] Secure the renewal of management assignment (job security).
[76] This was because in his quotation he mentioned "earnings manipulation" not "earnings management" as the more appropriate term.
[77] It is the literal translation of an Arabic word. They mean that management try to appear nice looking in terms of achievements so as their positions are secured and renewed.

responses by dividends in both private and public banks. RG3 who is an inspector at the CBL stated:

> "To distribute dividends, the public banks became more concerned about earnings management when they started to give a portion to employees recently since about four years ago. After this they tended to increase the profit so that they can pay dividends to employees and themselves as well".

Another regulator, RG4, also commented:

> "They tend to increase the profits rather than decreasing and they do that mainly to get shareholders satisfied and to have dividends".

Other reasons were mentioned during the interviews. RG5 commented that earnings management is exercised to send a message that a "manager is successful".

In a previous quotation one interviewee explained why he believes that all banks are managing their income by saying that he has never seen any bank that incurs a loss. This was also noticed by AD3 who expressed his fears that some new regulation could have a severe influence on banks' accounts:

> "We have noticed recently that the trend is to maximise the profit; management is concerned to show success and profit distribution. In recent years they face a new problem in the calculation of the provisions. Before, bad debts should have a provision of 60% now any bad debt will have 100% provision. A lot of old bad loans are there in banks accounts so it is difficult for managers to calculate the real provision as the bank might collapse".

Managers may also be engaged in earnings management for the reason of fraud. This notion emerged in the answer of US1, who is also an external auditor, in the following statement:

> "According to my experience, earnings management is practiced to cover corruption and to get some personal benefits in the form of a bonus. It is also practiced to satisfy shareholders so managers retain their positions".

It appears that there is a belief amongst the interviewees that earnings management is motivated by issues relating to job security and satisfying shareholders. This belief reflects the interviewees' acknowledgment that the accountability mechanism is to a large extent compromised when managers are concerned about their position. In other words, it is widely believed that there is a potential conflict in bank managers being held fully accountable, as long as they are concerned about their jobs, for example. Therefore, they might be giving biased accounting information for this reason. Accountability in such circumstances may be seriously compromised. The existence of such circumstances (i.e. earnings management motivations) may affect the relationship between LCBs' managers and their accountees. LCBs' managers may therefore be put under certain pressure to behave unethically by practicing earnings management which eventually will provide biased accounting information. However, an accountability framework as reported in Table 4.1 acknowledges the accountor's desire to present the accounting information in the best possible way.

6.4.4 Earnings Management Ethics

This part of the interviews, (Q11, Table 6.1) sought to explore the interviewees' views about the ethics and acceptability of earnings management practices. Replies vary between respondents. Table 6.11 summarises interviewees' perceptions about the ethics of earnings management practices where a "yes" answer reflects the interviewee's perception that earnings management practice is ethical and acceptable, and a "no" answer means that the interviewee considers earnings management practices are neither ethical nor acceptable.

The overall result suggests that there is as reported in Table 6.11, a disagreement between Preparers and other stakeholder groups. Although one might expect a preparer to justify the practice of earnings management, given the fact that motivations exist for them to manage earnings, it was expected that other groups would perceive that earnings management was unethical practice. Accounting information should be given in a way that is not biased so that one can say that it has been fairly presented to the accountees. If accounting information unbiasedly presented and was accepted by other groups other than preparers it would have a serious effect to the accountability mechanism. The acceptance of such behaviour may adversely affect many stakeholders' interests and reflect a serious threat to the accounting system whose main objective according to Ijiri (1983), is to provide fair accounting information. The accounting information, under the accountability framework, has to be, inter alia, objective which may not be the case when earnings management occurs and is perceived as an ethical practice.

Since accountee groups should be more concerned about looking for unbiased accounting information, this unexpected result could be due to the fact that such groups are unaware of earnings management consequences and their impact on the quality of financial reporting; indeed, the interview findings of Q4 (Table 6.1) suggest that 75% of interviewees have wrongly interpreted the earnings management term. It again reflects the disagreement and the lack of trust between the preparers and other stakeholders groups.

Table 6.11: The Ethics of Earnings Management Practices

Interviewee	Q11: Is earnings management ethical?	Aggregate
PR1	Yes	8 preparers (67%) believed that earnings management practices are ethical
PR2	Yes	
PR3	Yes	
PR4	Yes	
PR5	Yes	
PR6	Yes	
PR7	No	
PR8	No	
PR9	No	
PR10	Yes	
PR11	No	
PR12	Yes	
AD1	Yes	Surprisingly, only 1 auditor (25%) believe that earnings management is unethical practice
AD2	No	
AD3	Yes	
AD4	Yes	
RG1	No	7 regulators (70%) think that earnings management is unethical practice
RG2	Yes	
RG3	Yes	
RG4	No	
RG5	No	
RG6	Yes	
RG7	No	
RG8	No	
RG9	No	
RG10	No	
US1	No	2 users (100%) consider earnings management practices unethical
US2	No	
The overall percentage that view earnings management as ethical is 50%, the other half view it as unethical		

Note: this table represents the interviewees' perception regarding the acceptable and ethicalness of earnings management practices.

A significant portion took the view that if earnings management was implemented within accounting standards and regulation then it is viewed as ethical, otherwise not. PR4 expressed the following view:

> "As long as [it is] within regulations and rules it is ethical".

PR3 gave a similar reply, he stated:

> "If implanted within GAAP[78] and the law then it is ethical".

Also, earnings management, it was felt, could be justified due to the nature of human beings. RG3 commented:

> "I consider it ethical; it is human nature always to try to maximise their benefits".

Consistently, AD3 expects the occurrence of earnings management and mentioned that there is no "pure accounting". He also outlined some factors that may push managers towards earnings management. His statement was:

> "In fact, we always say that social environments or practices e.g. accounting is unlike chemistry or physics where 1+1=2. Accounting and management are affected by the economic, political, social and cultural environments so no way there will be pure accounting or pure management. During the last seven years I have been fully involved in audit with managements that suffered from a lot of things; bored staff, weak staff, old debts with the state, laws and regulations that are complicated and unclear, lack of skilled staff, unjustified tightening by the CBL, unethical and severe competition with other banks. Management operating in such an environment like that one cannot say it is ethical or not. Managers try to fix what can be fixed in favour of the bank and deal with real problems and ask the auditor to understand the situation when the CBL issues a new regulation and asks for it to be applied in one year giving no room to study and understand it. This puts the auditor in an embarrassing situation as he will be considered neither not cooperating nor forgiving if he insisted on the application of the new regulation. I don't accept a bank to be collapsed as a consequence for applying regulation so you have to accept. Life is not static and people work in very tough circumstances and suffer the old regime legacy. It is not acceptable but you find a justification for it at least some times with a condition that the practice is in the best interest of the company. According to my experience managers try to save what can be saved".

Also it was suggested that earnings management could be justified just like tax planning. AD4's statement was as follows:

[78] Although there are no local accounting standards, the term GAAP is widely used to refer to US GAAP. The accounting system education, as reported in Chapter 2, is American oriented.

> "You remind me of tax planning and tax evasion. Sometimes I view management as being forced to do it in the light of unusual circumstances. A company may have a high profile in an unusual year so this trend is unusual given that the real value of the firm won't be accurately determined unless in case of liquidation. Accounting standards depend on discretion in some cases and this enables the manager to act in some circumstances for example in Libya the old tax law was not permitting the recognition of bad debts. I remember a bank that was not allowed to include bad debts in their accounts and resulted in a net profits total of 80% of revenues and of course this was not real. It is acceptable in the light of unusual conditions to maintain the going concern. Being extreme in everything leads to break down. Another example, a bank has issued a guarantee letter of 400m LD for one company that later failed; if I insisted to make the provision of 400m LD the bank will collapse because their capital was only about 400m LD so you have to give some room to the other (manager)".

On the other hand, other interviewees completely refuse to accept that earnings management is appropriate. RG1 for example stated:

> "Earnings manipulation in general is unethical".

RG8 indicated that a company should be attached to its principles. The following statement was offered:

> "Of course [it is] unethical, every institution is supposed to have principles, policy and a general overview (plan) that it works to achieve with the basic rule being that not achieving any target at the expense of a principal".

Within an accountability framework, bank managers have to act in an ethical manner. Therefore providing biased information (i.e. when earnings management is practiced) could reveal that bank managers are not accountable. The interview findings for this question identify what appears to be a really serious problem when 50% of interviewees perceive that earnings management is ethical; it could lead to acceptance of such practices. Again this finding should be looked at while taking into consideration the findings of Q4 (Table 6.1) presented in Table 6.5 which reveal that 75% of interviewees did not know the meaning of the term earnings management.

6.5 Interviewees' Perceptions about the Role of Accounting Standards, Corporate Governance and the External Auditor

6.5.1 The Role of Accounting Standards

Interviewees were asked if the absence of local accounting standards would have any influence on the practice of earnings management (Q12, Table 6.1).

Only two respondents, AD2 and PR11 believed that the absence of local accounting standards would not have an impact on the practice of earnings management. The reason, as PR11 suggests, is that some alternatives to local accounting standards are available; he indicated:

> “I don’t think so, because although we don’t have local standards we still have the IFRS or GAAP which could be used by any accountant in the world”.

On the other hand, the majority of interviewees, 93%, agreed that the lack of accounting standards contributed to the incidence of earnings management, AD3, for example, has commented:

> "The absence of standards opens the door for manipulation. We need standards as a background for using as one language. Any standards would help even from anywhere".

Also, RG9 viewed the absence of local standards as a big opportunity for preparers to do what they want. He stated:

> "Sure, freedom and you have the stadium open[79]".

PR10 suggested that managers have excuses when there are no accounting standards. The existence of local accounting standards can act as a defence for the accountant who refuses to do anything wrong when asked to do so. He offered the following statement:

> "If there were local accounting standards it would make clear how to account for a specific event. If I was an accountant and my manager asked me to do something I can say no because the accounting standards require a specific treatment".

[79] By this, he meant, the door is opened.

Given the absence of local standards in Libya, some interviewees felt that they needed other standards to be in force. PR5 believed that:

> "Due to no local standards, any standards would be ok, better than nothing".

The second question (Q13, Table 6.1) in this part of the interview asked interviewees whether they thought that IFRS, if applied, would have any effect on the practice of earnings management. Table 6.12 summarises interviewees' responses regarding the potential effect of applying IFRS on earnings management practices; the responses are presented in form of "yes" and "no". A 'yes' response refers to the interviewee thinking that adopting IFRS would positively restrict the earnings management behaviour while a 'no' answer refers to the interviewees' belief that there would be no impact on the practices of earnings management if IFRS was imposed.

Table 6.12: IFRS Influence on Financial Reporting Quality by Interviewees

Interviewee	Q13: Will adopting IFRS have a positive effect on earnings management?	Aggregate
PR1	Yes	11 preparers (91%) believed IFRS would positively affect the earnings management practices and therefore improve reporting quality
PR2	Yes	
PR3	No “there is no good understanding of IFRS”	
PR4	Yes	
PR5	Yes “as no local standards so far”	
PR6	Yes	
PR7	Yes “to some extent”	
PR8	Yes	
PR9	Yes	
PR10	Yes “it will prevent illegal manipulation”	
PR11	Yes	
PR12	Yes	
AD1	Yes	All 4 (100%) of auditors believe that adopting IFRS leads to mitigating earnings management practices
AD2	Yes	
AD3	Yes	
AD4	Yes	
RG1	No	6 (60%) out of 10 regulators think applying IFRS would reduce the earnings management practices and therefore, financial reporting quality could be improved
RG2	Yes	
RG3	Yes	
RG4	Yes	
RG5	Yes	
RG6	No	
RG7	Yes	
RG8	No	
RG9	Yes, quality would be 100%	
RG10	Don’t know about IFRS	
US1	No	The Users’ responses come somehow differently, where only 1 user (50%) think of no positive impact for adopting the IFRS on earnings management, others looks like not sure about the consequence of such a procedure
US2	Depends on how to apply them	
21 interviewees (75%) believe that IFRS would have a positive influence over financial reporting quality		

Note: This table shows the interviewees’ perceptions regarding the impact of adopting the IFRS on the earnings management practices.

A majority of the interviewees (21, or 75%) agreed that IFRS would have a positive impact on earnings management and that it would improve financial reporting quality. This result reflects the interviewees’ belief that adopting IAS/IFRS would restrict earnings management and the accountability mechanism would, therefore, be effectively enhanced. In addition to the fact that there are no local accounting standards to govern the current accounting practices in Libya generally and within the banking sector in particular, such a finding could refer to the importance of either issuing local accounting standards or adopting IFRS so that accountability is enhanced. The importance of adopting a framework to govern the accounting practices would lead to high quality accounting information. The existence of a theoretical framework would provide the basis of stability on which accounting information can be provided as reported in Table 4.1.

Apparently adopting IAS/IFRS for the accounting practices in Libya would not be without its shortcomings as suggested by RG9[80] who believes that IFRS would affect net income negatively. He indicated:

> "If IFRS was applied the quality of financial reporting would be 100% but there will be decreasing in the profits over the first years because you have applied standards that wiped out the provisions and recognised all of them as a loss".

Applying IFRS at one time (i.e. in one step) might not be the right solution even in the case that the State itself asked for this. RG9 and AD4 suggested that IFRS should be applied step by step. The interviewee RG9 recommended:

> "The wisdom is to apply IFRS gradually, not all in one go, also it is not a button to press; to apply the IFRS you need to train staff about it which would take time".

Another interviewee agreed with this notion. AD4 similarly said:

> "Our standards should be IFRS. My view is to apply IFRS gradually since not all IFRS are applicable".

In contrast, some interviewees seem to have a different perception about IFRS. US1, for example, who thinks that the quality of financial reporting is poor and believes the practice of earnings management to be unethical, advocates the issuance of local accounting standards rather than using the international ones. He considers that local standards are more suitable, and therefore more applicable, than their international counterparts. He said:

> "No, the international standards are not good for the Libyan environment. The good standards are those applicable (local) standards"

Similarity, RG6 believes that accounting standards should be a product of the surrounding environment. His comment was as follows:

> "I don't believe in international standards. Standards should be derived from the environment".

[80] It is worth noting that RG9 regard the financial reporting quality as being poor and that earnings management is widely practiced by LCBs.

Whatever the accounting standards to be applied (i.e. local standards or IFRS) the importance of such a framework was stressed by most of the interviewees since the accountability process would be less effective without them. Therefore, based on the interview findings that 75% of interviewees perceive IFRS would produce high quality financial reporting it could be suggested that adopting IFRS would play a positive role in terms of an accountability system. Though it should also be noted that there is a view that great care should be taken over the way in which they are adopted (i.e. gradually).

6.5.2 The Role of Corporate Governance

The second important factor in mitigating the practice of earnings management that was discussed during the interviews was the role of good corporate governance. Q14 (Table 6.1) sought to explore the interviewees' perceptions regarding how good corporate governance could influence the exercise of earnings management. Twenty five interviewees (89%) believed that good corporate governance would effectively mitigate the practice of earnings management. According to PR10, for example:

> "It will constrain the management and prevent it from overriding the normal procedures. Good corporate governance will separate functions so it would be difficult for managers to manage earnings".

Such a finding could lead to an assumption that in order for an effective accountability mechanism to be applied, corporate governance codes, among other things, should be practiced. This could be affected by the position of the interviewee i.e. agent or principal as others seem against corporate governance and consider it as having no influence on earnings management. PR1 the chairman of a commercial bank completely disagreed with the notion of the value of corporate governance in general and thinks that it is not applicable in Libya due to the fact of the lack of qualifications among Libyan citizens. He said:

> "I am against corporate governance[81], Basel 2 and 3, and splitting between functions[82] in Libya as there is no corporate governance and they couldn't

[81] PR1 is the chairman of a private commercial bank, he is one of the founders of that bank, and actually he is the first of them who advocated establishing it. So effectively he was chairman, general manager, accounts

split them due to no qualifications. For me it is nonsense, theory only. But if it is implemented in a good way it would tackle the earnings management".

However, PR1 agreed that good corporate governance could have a role in deterring earnings management if it was only "implemented in a good way".

One of the interviewees, RG6, suggested that earnings management might be exercised even with good corporate governance:

"I don't think so. Earnings management could be practiced within laws and with good intent".

On the other hand, good corporate governance, if it did not resolve the issue, it would at least control it, according to RG4. It is arguably needless to stress the importance of the role of corporate governance in the accountability process. However, the above discussion reveals an awareness by some interviewees regarding the important role that good corporate governance could play in improving financial reporting quality and thus the accountability process. Better corporate governance can increase public confidence in the integrity of the financial reporting process and in the credibility of the accounting information generated from the entity. Some corporate governance rules may restrict LCBs' managers and make them work in the interest of shareholders and other stakeholders.

Table 6.13 briefly outlines interviewees' perceptions in respect of the effect that good corporate governance could have in relation to deterring managers from being involved in earnings management practices.

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chief (he is a certified accountant) and almost everything in that bank, that's why he did not like it when the central bank issued the corporate governance guide and asked to split the function of chairman and general manager into two positions. This may clarify why his response may be seen as contradictory.

[82] He is referring to the function segregation between chairman and general manager positions that is required by most corporate governance codes.

Table: 6.13: Good Corporate Governance Influence on Financial Reporting Quality

<table>
<tr><th>Interviewee</th><th>Q14: Can good corporate governance deter earnings management?</th><th>Aggregate</th></tr>
<tr><td>PR1</td><td>Yes</td><td rowspan="12">11 Preparers (91%) agree that good corporate governance would negatively impact earnings management practices</td></tr>
<tr><td>PR2</td><td>Yes</td></tr>
<tr><td>PR3</td><td>Yes</td></tr>
<tr><td>PR4</td><td>Yes</td></tr>
<tr><td>PR5</td><td>Yes</td></tr>
<tr><td>PR6</td><td>Yes</td></tr>
<tr><td>PR7</td><td>Yes</td></tr>
<tr><td>PR8</td><td>Yes</td></tr>
<tr><td>PR9</td><td>Yes</td></tr>
<tr><td>PR10</td><td>Yes</td></tr>
<tr><td>PR11</td><td>Not answered</td></tr>
<tr><td>PR12</td><td>Yes</td></tr>
<tr><td>AD1</td><td>Yes</td><td rowspan="4">All Auditors (100%) believe applying good corporate governance could deter managers of being engaged in earnings management practices</td></tr>
<tr><td>AD2</td><td>Yes</td></tr>
<tr><td>AD3</td><td>Yes</td></tr>
<tr><td>AD4</td><td>Yes</td></tr>
<tr><td>RG1</td><td>Yes</td><td rowspan="10">8 Regulators (80%) think that good corporate governance can mitigate earnings management</td></tr>
<tr><td>RG2</td><td>Yes</td></tr>
<tr><td>RG3</td><td>Yes</td></tr>
<tr><td>RG4</td><td>Yes</td></tr>
<tr><td>RG5</td><td>yes</td></tr>
<tr><td>RG6</td><td>No</td></tr>
<tr><td>RG7</td><td>Yes</td></tr>
<tr><td>RG8</td><td>Yes</td></tr>
<tr><td>RG9</td><td>Yes</td></tr>
<tr><td>RG10</td><td>No</td></tr>
<tr><td>US1</td><td>Yes</td><td rowspan="2">All Users (100%) showed their agreement as good corporate governance can affect the practice of earnings management</td></tr>
<tr><td>US2</td><td>Yes</td></tr>
<tr><td colspan="3">25 (89%) of interviewees believe that applying good corporate governance in LCBs could have deter LCBs' manager from being engaged in earnings management practices.</td></tr>
</table>

Note: This table shows the interviewees' perceptions regarding applying good corporate governance in deterring the practice of earnings management.

As Table 6.13 shows, most interviewees (89%) believed in the potential role of applying good corporate governance in relation to reducing earnings management by LCBs. In other words, accountability in LCBs is perceived to be potentially enhanced, partially, by applying good corporate governance.

In the next section, the role of the external auditor in relation to earnings management is addressed. Interviewees were asked whether the external auditor was able to detect and prevent the practice of earnings management by LCBs' managers.

6.5.3 The Role of the External Auditor

Auditors' ability to detect and prevent the practice of earnings management was also discussed with interviewees (Q15, Table 6.1). They were asked whether, and to what extent, they thought that the auditor is able to detect and prevent managers from being involved in earnings management. Table 6.14 summarises the interviewees' responses to this question.

Table 6.14: The External Auditor's Ability to Detect and Deter Earnings Management

Interviewee	Q15: Can the external auditor detect and deter earnings management?	Aggregate
PR1	Can detect and deter	All Preparers (100) confirmed the external auditor's ability for detecting earnings management, but only 5 (41%) believe of the auditor's ability to deter the practice. On the other hand, 6 Preparers (50%) think that auditor cannot deter the practice
PR2	Can detect and deter	
PR3	Can detect, cannot deter	
PR4	Can detect, cannot deter	
PR5	Can detect	
PR6	Can detect and deter	
PR7	Can detect, cannot deter	
PR8	Can detect, cannot deter	
PR9	Can detect, cannot deter	
PR10	Can detect, cannot deter	
PR11	Can detect and deter	
PR12	Can detect and deter	
AD1	Can detect, cannot deter	All Auditors who answer this question (3 out of 4) see the external auditor able to detect the practice but not able to deter it.
AD2	Did not answer question	
AD3	Can detect, cannot deter	
AD4	Can detect, cannot deter	
RG1	Can detect	9 out of 10 Regulators think that external auditor is able to detect earning management but only 2 (20%) believe the external auditor ability to deter it.
RG2	Can detect and deter	
RG3	Can detect, cannot deter	
RG4	Can detect, cannot deter	
RG5	Can detect and deter	
RG6	Can detect, cannot deter	
RG7	Can detect, cannot deter	
RG8	Cannot detect	
RG9	Can detect, cannot deter	
RG10	Can detect, cannot deter	
US1	Can detect, cannot deter	The only User who answered believed that external auditor can detect earnings management but not deter it
US2	Did not answer question	
25 (89%) of interviewees believe of the external auditor ability to detect the practice of earnings management but only 7 (25%) think of the external auditor ability to deter it.		

Note: This table shows the interviewees' perceptions regarding the external auditor's ability in detecting and deterring the practice of earnings management.

As noted in Table 6.12, all Preparers are in agreement about the external auditor's ability to detect earnings management but their views in respect of whether the external auditor can deter the practice of earnings management showed almost equal results; 5 of them believe that the external auditor can deter it while 6 Preparers hold the opposite view that they cannot deter it. All Auditors who have answered this question said that the external auditor can detect the practices of earnings management but will be unable to deter it. The majority of Regulators (9 out of 10) think that the external auditor can detect earnings management practices but only 2 (out 9 who believe he/she can detect) think that the external auditor can deter earnings management. On the other hand, 6 out 10 Regulators acknowledged the external auditor's ability in deterring the earnings management practices. The only User who answered this question gave the view that the external auditor is able to detect earnings management but is unable to deter it.

PR1, for instance, suggested that the auditor is able to prevent through his opinion and can detect the earnings management practices. On the other hand, the ability to prevent such a practice apparently is affected by a number of factors as will be discussed later. The majority of interviewees (82%) agreed that the external auditor can detect earnings management if he/she is qualified. As for preventing earnings management, responses come in different ways. Some say that he can prevent it through 'waving'[83] his/her report and some say that he cannot prevent it for some reasons. PR4, for example, mentioned the fees amount that an auditor may lose in case of any conflict with management. He said:

> "The auditor is supposed to be qualified to detect it through the process of audit. It depends on his personality if he is not caring about the money he would say "no". But actually most of them say ok. Our fees have reached 50,000 LD".

The external auditor efficiency, which is a central issue within the accountability mechanism[84], is seen to be compromised by the high audit fees commercial banks usually pay and also the personality of the individual external auditor. Ironically, the external audit represents a very important element in the accountability process which theoretically should be enhanced by the payment of high fees to reflect rigorous and high quality audits.

[83] Threatening that he/she may issue a qualified opinion.
[84] If the external audit was not properly carried out the quality of financial information may not be assured. Given the fact that that financial information may have been managed and therefore less quality financial information is being provided.

Those high fees themselves could, however, harm the accountability as the external auditor may do anything to ensure that these fees are maintained and secured.

Also, interviewees perceived that an auditors' experience plays a significant role in detecting earnings management practices. In the year one of an audit, auditors may not be experienced enough in relation to understanding the new client’s business to detect earnings management as expressed by PR5 and PR12 who respectively said:

> "It depends on what is the experience of the auditor in terms of time; an auditor for one year could not, but an auditor who has being auditing for five years for instance could detect and can give some advice on how to reduce the practice".

> "External auditor in his first time of auditing will not be able to detect it. But if he discovered he can prevent it".

The notion of audit tenure[85] was also mentioned in the response of PR10 who also blamed limited audit samples for not uncovering earnings management practices.

> "To some extent, the external auditor can detect earnings management, but only to some extent as he will take samples. He will not be able to audit all transactions. When he detects the earnings management, it is supposed that he has the power to prevent it. Due to the limited number of auditors who are qualified to audit big institutions, the more the auditor becomes familiar with the institution the more the auditor creates a kind of relation with the institution that makes the auditor work for the management instead of shareholders".

The audit process itself could be seen, as in above quotation, as one of the factors that could affect the detection of earnings management practices. This was also stressed by US1, who considered the problem of audit samples by saying:

> "Yes, the auditor can discover it. But not all earnings management practices because of audit samples. The auditor is one of the tools to discover earnings management practices. The auditor needs standards, and professional management in order to be able to discover, also has to be qualified. This is a big question that cannot be answered easily; auditor has to be protected when appointed and when terminated. He has to have standards to be applied".

[85] According to the CBL’s regulation, an auditor can only be assigned for maximum two years for same bank. However, the relationship may be back again after a one year audit by another auditor.

Auditor independence represents a core element in the audit function and thus in the accountability process. AD1 described the relation between auditors and management by saying:

> "Auditor assignment is 90% or 99% dependent on personal contacts so an auditor's decision is consistent with the management's desire".

In the same vein, RG1, when asked to rate the efficiency of listed auditors, mentioned the problem of personal contacts in appointing the external auditor. He said:

> "Not all of them are at the same level of efficiency. Some audit assignments are based on personal contacts and are regardless of the effectiveness or efficiency".

The accountability process can be seen as less effective once an auditor's independence is compromised; therefore more efforts have to be taken in order to enhance auditor independence.

AD3 commented:

> "If he was capable he would detect it. The profession is suffering. In Libya there is a problem unfortunately; industry got a lot of unqualified auditors meanwhile a lot of qualified people as well. The market and life circumstances play a role in making auditors give up (no resistance) to the management. I know and you know there are some auditors who only have one client and he is not braced for losing it".

The profession itself could contribute to an auditor's ability to detect and prevent earnings management practices. For example, PR3 has said:

> "Most external auditors don't prevent the practice of earnings management. The audit function is traditional in Libya".

This suggests that the improvement of the entire profession (which arguably could start with the setting of accounting standards) is needed in order to back accounting practices and therefore facilitate the audit function. In other words, the conceptual framework would empower the accountability process.

PR10 also commented on this issue in assessing the listed auditors' efficiency by saying:

> "They have the experience in banks audit. They have the ability. But they are a bit traditional, they are not following the technology".

Earnings management itself could be the reason why auditors cannot detect or prevent it. RG8 commented:

> "Well it is a new topic and most auditors have no idea about it so I think they cannot detect if. On the other hand, the independence of the auditor is all the time questionable".

The external auditor plays a crucial role in the accountability relationship, his/her role is to give assurance and confidence that financial statements faithfully represent the financial situation of the firm. This role may be impaired by some factors, as interview findings show a view that the external auditor's effectiveness may be affected by knowledge, experience, conflict of interest (fees, tenure) and audit procedures and sampling. Therefore, and based on interview findings, the external auditor's effectiveness is questionable and therefore accountability would be judged as being breached. Moreover, the interview findings reported in Table 6.13 suggest that 89% of interviewees acknowledge the ability of the external auditor in detecting earnings management practices, but only 25% of interviewees believe that the external auditor is able to play a role in deterring LCBs managers from being engaged in earnings management. This suggest that accountability is to some extent affected by the personality of the external auditor that was suggested by PR4 when he was speaking about the high fees for bank audits.

The second question in this area (Q16, Table 6.1) was to ascertain views about the ability and efficiency of auditors who are listed at the CBL[86] and thereby authorised to audit banks. Some interviewees see that most of those listed auditors have the capability to audit banks and some see that only a few auditors have the efficiency for banking audit.

PR1 has stated:

> "It is a very good question. Only those who have audited banks and got the experience. Not all of them are qualified to audit banks".

[86] As previously discussed, in Chapter 2, the CBL maintains a register of listed auditors who are only permitted to audit banks.

This might lead to the question of what standards does the CBL follow in listing external auditors. PR3 raised this query:

> "The auditors who are listed and authorised to audit banks, I am not convinced about them, because there are no standards to accept the auditor and licence him to audit banks".

This question sought interviewees' perceptions regarding listed auditors and whether they are capable for bank audit so that one can judge about the accountability relationship of LCBs. Listed auditors presumably are effective and capable of bank audit however, the interview findings showed mixed views.

Interviewees were also asked to determine the extent to which the auditor's report is used by various stakeholders (Q17, Table 6.1). Libyan stakeholders may lack the culture and tradition of reading the reports as declared by RG1 who said:

> "Some ways of manipulation are easy to detect but giving a qualified opinion is not enough because of inaccuracy of the auditor's report on one hand. On the hand there is no report reading culture by interested parties... the use of the auditor report is very limited and in most cases is informal".

RG5 thinks that the auditor's report is only a legal requirement and that no one is using it. He said:

> "There is no relying on it at all. It is only a legal requirement".

RG9 also suggested:

> "Unfortunately it is a legal requirement by the LSM and I don't think people are interested in it".

Interviewees view the CBL, LSM, tax authorities and management as the stakeholders who are most interested in the auditor's report. PR1 added correspondent banks as another party which is interested in the external auditor's report. He also commented on investors' use of the auditor's report. He said it was:

> "Supposed to be very important for the CBL and the LSM and correspondents are very interested in the auditor's report. Investors are not, as they depend on their broker when deciding on buying or selling shares".

According to, PR4, no one is using the auditor's report. He noticed:

> "Supposed to depend on it, but I don’t think they do use it here".

The auditor’s reputation may have a role on it being used. PR11 stressed the good reputation of the auditor. He stated:

> "The owners are much more interested in the detailed report[87] rather than an opinion report. Also the auditor himself plays an important role for example a report signed by one auditor, for example, will be accepted by the tax authority with no suspicion, on the other hand another auditor's report could be thrown away".

For AD4 only foreign companies are interested in the auditor's report while the local authorities only ask for it as a legal requirement. He observed:

> "Frankly no one uses it [the auditor’s report] except the foreign companies who send it to their head offices in order to make the consolidated statements. In Libya they use it as a legal requirement only. One time in a general assembly meeting the auditor was not invited to read his report".

As understood, the main functions of the external auditor are to examine the financial statements and to provide an opinion based on that examination. In other words, the external auditor’s role within the accountability system is fulfilled when the external auditor’s report is issued. In the case that this report is not being used, the accountability system may not be fully implemented. It could also reflect lack of awareness by various stakeholders about the accountability system in general and that the role of the external auditor in the accountability process in particular.

The questions 18 and 19 (Table 6.1) attracted no interest or comments from the interviewees, and therefore, the researcher was not able to report about them.

6.6 Summary

This Chapter examines and reports the findings obtained from twenty eight interviews conducted with a variety of LCB stakeholders from the two main cities in Libya; Benghazi and Tripoli. The interview findings indicate that the majority (97%) of stakeholders

[87] There are, in Libya, two reports an auditor has to submit to the general assembly; a detailed report which normally consists of auditor’s remarks on the internal control system and any mistaken transactions, the other is the opinion report.

perceive that financial reporting is important. Also a significant portion of interviewees (57%) view the quality of financial reporting as being not good. The interview findings also revealed that there is a lack of understanding of the terminology and the concept of earnings management. Twenty two interviewees (79%) had not heard of the term and when they were asked about the term's connotation, apparently some of these who indicated that they were familiar with the term actually did not really understand the real meaning of it as 82% of the interviewees interpreted the term in a wrong way; i.e. how to invest and reuse the earned profits. The findings suggest that translation of the term may have led to this misinterpretation of the term and that "earnings manipulation" might be more informative.

Interview findings suggest that earnings management is relatively widely practiced within LCBs as 53.5% of interviewees believe that LCBs are engaged in earnings management practices. Given the impact earnings management would have on the quality of financial reporting it can be said, based on the interviewees' perceptions, that LCBs financial reporting is affected by the practice of earnings management and therefore is of reduced quality which may reveal a serious threat to the accountability system for LCBs stakeholders.

Interview findings also suggest that the loan loss provision (LLP) is one of the key mechanisms by which bank managers alter the reported income; this was referred to by 64% of interviewees who believe LLP is being used by LCBs to manage earnings. As for who is the main stakeholder to LCBs, the interview findings suggest shareholders are seen as the main stakeholder for LCBs; the percentage was 75% of interviewees who indicated that.

In regards to what motivates bank managers to indulge in the earnings management practices; overview results indicate that about 50% of interviewees view job security as a principal factor to induce bank managers to engage in earnings management practices.

The ethics of earnings management was also explored; the interview findings pointed out that 50% of the interviewees perceive earnings management as being ethical while the other half perceive it as unethical. In more detail, 67% of Preparers view earnings management as acceptable which might not be surprising. On the other hand, 100% of Users and 70% of Regulators see that earnings management is not ethical, but only 25% of Auditors see earnings management as unethical.

Based on above results, it can be seen that there is strong evidence that earnings management does exist in LCBs' financial reporting resulting in their quality being impaired. Also, earnings management is perceived to be mainly exercised using LLP. This behaviour is to a large extent motivated by job security. This behaviour is being seen as both ethical and unethical as well, since only half of the interviewees perceived it as ethical. One of the main factors that make such behaviour easy for LCBs' managers, as per interviewees' perceptions, is the absence of local accounting standards. Based on all the above one can say, from an accountability perspective, that the above findings are leading to an assumption that the accountability of LCBs is really under threat. The remaining results show how such accountability could be promoted from the view point of the interviewees.

Interviewees were also asked to indicate whether lack of local accounting standards, weak corporate governance and the external audit function may have an influence over the existence of earnings management within the LCBs and in this regards, interviews suggest that absence of local accounting standards have an impact suggesting that adopting IFRS would positively impact the financial reporting quality and deter earnings management practices. Also, the corporate governance tools are believed, when are well applied, to have an influence on earnings management practices.

As regarding the external auditor's role in mitigating the earnings management practices, there was a relatively wide agreement amongst interviewees (89%) that a qualified external auditor may easily detect earnings management practices but as to deter the practices the interviews findings reveal that only 7 or 25% of interviewees think that an external auditor is able to effectively deter earnings management practices. The interviewees referred to some issues that may affect the external auditor's effectiveness; knowledge, experience, conflict of interest i.e. fees, and audit sampling.

The auditor report represents the auditor's potential power towards influencing management actions in terms of earnings management, but in Libya, this is thought to often not be the case. The interview findings indicate that the auditor's report is often viewed as only a legal requirement and is not used when it comes to make economic decision regarding the financial position of a bank.

Chapter 7

Questionnaire Analysis

7.1 Introduction

As previously outlined, this study aims to explore the views and perceptions amongst the various stakeholders of the Libyan Commercial Banks regarding earnings management practices and related issues. As mentioned in the previous chapter, interviews were used, as the first method in this study, to investigate and explore the perceptions of a variety of relevant stakeholders about the topic of earnings management. The second method used in this study was a questionnaire survey, which was partly built on the findings of the interviews analysis presented in Chapter 6. Questions were also based on a wide review and analysis of the existing related literature. This chapter contains six sections. Following the introduction, Section 7.2 outlines the questionnaire design and structure; Section 7.3 highlights the questionnaire piloting and administration process; Section 7.4 reports the reliability and validity tests for this questionnaire; Section 7.5 presents the data analysis process and shows the findings of this analysis; while Section 7.6 provides a summary of the chapter.

7.2 Questionnaire Design and Structure

Chapter 5 discussed and explained the interpretive paradigm was adopted to satisfy the research objectives of this thesis. It also outlined that the survey questionnaire was chosen as one of the two methods for data collection. A questionnaire survey is one of the most widely used methods in social science research (Blaxter et al., 2010). According to Sekaran (1992), it is an efficient method for data collection where it is reasonably clear to the researcher what information is required, and is a way to measure the variables of interest. In order to develop an efficient questionnaire, or, in Bell's (2010) words, "to produce really good questionnaires…" it "requires discipline in the selection of questions, in question writing, in the design, piloting, distribution and return of the questionnaire" (p. 140). Considerable time and effort have been devoted towards the design for this study's questionnaire; questions were prepared and written carefully and special attention was paid to the layout and the ordering of the questions; they were structured in a logical manner so that they were easy to read and follow. Also attempts were made to make the questionnaire clear and uncluttered in order to encourage respondents to complete and return the questionnaires[88]. This questionnaire adopts the "funnel approach" that was suggested by Oppenheim (1992). According to this approach, questions are designed to flow from a general or a wide idea to a specific or narrow idea. The advice of Saunders et al. (2012) is that a considerable amount of time should be spent on the order and flow of the questions to ensure that they and their order, are logical to the respondent. In this questionnaire, questions of similar content were grouped in one section; for example, all questions related to financial reporting quality and earnings management were included in Part 2. This study's questionnaire started from the quality of financial reporting and led to questions exploring disincentives in respect of financial reporting. The questionnaire appearance is highly important; Robertson and Dearling (2004) pointed out that a questionnaire's layout is a crucial matter that has to be considered. They added: "[n]ot only should the document look professional, but good layout is also an essential element for the smooth running of any questionnaire" (p. 145). As mentioned earlier, there was specific feedback that the questionnaire was successful in having a professional appearance. The questionnaire consisted of seven A4 pages; including the covering letter and two open ended questions which gave a reasonable space for comments; in other words, the total number of pages for

[88] Some respondents expressed their admiration for the order of the questions; they liked the order which starts by investigating perceptions of earnings quality, then goes to understanding and, if necessary, clarification of the term earnings management and its related issues.

closed ended questions was five pages which was considered to be reasonable[89]. The questionnaire, in both English and Arabic can be found in Appendices 7.1 and 7.2.

Questionnaire questions can either be open or closed ended; in open questions the respondent is left with a space to write their answer; open ended questions usually begin with the words like “How”, “Why”, “What”, etc. In such questions respondents should be offered an adequate amount of space to write down an answer without unreasonable restrictions. Although responses to open ended questions may be difficult to analyse, they might lead to a richness in the results with interesting and unexpected responses (Gray, 2004). Closed ended questions, on the other hand, are those questions in which a respondent is given the opportunity to choose one answer from a set of pre-selected alternatives; this type can range from a simple form e.g. Yes/No, Male/Female to a 5-point ‘Likert’ ranking scale of alternatives for the respondent to choose from (Hall and Hall, 1996). Such questions allow easy coding for analysis (Gray, 2004). This questionnaire comprised a mix of open and closed ended questions as will be discussed later. Part 1, for example, consisted of both types of questions. It asked for participants’ age, for example, by giving five answers (age ranges) to choose from as well as open questions, for instance, respondents were asked to write about their experience, if any, in the banking sector. With the exception of Question 2.2, all other questions used a Likert scale where participants were asked to determine the strength of their feeling towards a given set of statements. The higher the answer chosen the higher the level of agreement the participant has (Bell, 2010).

The questionnaire structure consisted of a covering letter and three parts with questions. The covering letter represents the questionnaire introduction which, according to Sekaran (2003), is of great importance, he pointed out:

> “A proper introduction that clearly discloses the identity of the researcher and conveys the purpose of the survey is absolutely necessary. It is also essential to establish some rapport with the respondents and motivate them to respond

[89] The reasonable length for a questionnaire, according to Bell (2008), should be between four to six pages.

> to the questions in the questionnaire wholeheartedly and enthusiastically. Assurance of confidentiality of the information provided by them will allow for less biased answers. The introduction section should end on a courteous note, thanking the respondent for taking the time to respond to the survey" (p. 245).

Sarantakos (2005) suggests that the covering letter has an influence on the response rate. The notion behind the covering letter, according to Sarantakos (2005), is to introduce the participants to the research topic and describe the main objectives and social significance of the study so that any uncertainties those participants may have can be eliminated. Also, the covering letter should assure anonymity and confidentiality which would encourage the respondents to participate in the survey. Respondents should be given reasons why they have been chosen to participate in the survey. Walliman (2011) suggested:

> "When sending out the questionnaire, you should courteously invite the recipients to complete it, and encourage them by explaining the purpose of the survey, how the results could be of benefit to them, and how little time it will take to complete" (p. 191).

In some cases, this researcher verbally explained to the participants that filling out the questionnaire could have a positive impact on their knowledge given the possible importance of earnings management on financial reporting quality and ultimately on financial decisions.

Considerable efforts were made to guarantee that important issues within the topic of earnings management were included in the questionnaire. In addition, the first part of the questionnaire was about the personal data of the participants which should have been relatively easy to complete. They were asked to determine their age, gender, qualifications, place of work and banking experience if any.

The objective of the second part was to elicit participants' perceptions about financial reporting quality and earnings management practices. In this part of the study, participants were asked to indicate if they had heard about the term "earnings management" and to indicate their understanding of the term[90]. They were given a variety of possible replies based on the differing ways in which the term had been understood by the interviewees. Then, participants were subsequently given a definition for earnings management in the sense that it was to be understood for the purpose of the questionnaire so as to have relevant replies to the rest of questions about earnings management motivations, techniques, constraints and ethical issues. This part also examined the accountability relationship between Libyan Commercial Banks' managers and their stakeholders.

The third part was designed to obtain questionnaire participants' views regarding the external auditor's role in connection with earnings management practices. The external auditor's efficiency and accountability were addressed as well as the use of the auditor's report by various stakeholders.

7.3 Questionnaire Piloting and Administration

It is highly recommended that a questionnaire be tested before it is distributedt. A questionnaire should be pre-tested on a small number of people from a similar group to that to be surveyed and this procedure is called a pilot study (Walliman, 2011). A questionnaire should be pre-tested to ensure that all questions and instructions are clear to participants, it is also good practice to test the time it takes a participant to complete it (Bell, 2010). It is suggested that asking two or three people of a similar group to go through the questionnaire under the supervision of the researcher would be extremely useful (Bill, 2008). This study's questionnaire was originally produced in English[91], which is not widely spoken nor an official language in Libya. Therefore, it had to be translated into the official language in Libya, Arabic. Precise wording of questions is of great significance in surveys therefore numerous efforts were undertaken to ensure an accurate

[90] One of the research questions deals with the extent to which earnings management as a term is known and understood by the various stakeholders of the LCBs.
[91] The questionnaire went through several revisions and discussions with the supervisors before the final draft was ready for translation and pilot testing.

translation by the researcher[92]. The first pilot study was undertaken in December 2012 in the School of Business at the University of Dundee on three PhD students who were undertaking their doctoral studies in different accounting topics. Their comments and ideas were important and resulted in some helpful suggestions. Their comments were mainly about the wording of some questions in the Arabic version of the questionnaire. The second pilot study was undertaken in Libya with three auditors, one of whom holds an MSc in accounting from a US university and two academics, one of whom holds a PhD from an Egyptian university, to ensure an accurate translation and understandability of the questionnaire. The questionnaire was handed out by the researcher during the pilot testing with an explanation of the research aims and objectives. When completed questionnaires were collected there was a discussion with each of the respondents about their comments and feedback and valuable comments were received in this way. The feedback was useful in terms of the Arabic translation and questions were modified based on the suggestions of two of the auditors.

Questionnaire surveys can be administered either by post or by the researcher, in person. Although a postal questionnaire may have some advantage in the sense of cost and the wide geographical distribution that can be achieved, it is not practical in Libya. Zagoub (2011) concluded that:

> "The post system in Libya is old and it is now under development. Therefore, individuals and organisations still depend on post boxes that are available inside the post buildings. Moreover, the e-mail system is still not commonly used in Libya and many of the individuals and organisations do not have this system" (p. 159).

Thus self-administration was selected, partially based on the above statement, and to a large extent due to the short time the researcher had to spend in Libya. Sekaran (2003) indicated:

[92] As an auditor, the researcher had frequently been asked to participate in questionnaires made by Libyan postgraduate students, it was notable to the researcher that the questions had not been carefully translated into Arabic which means that the student had just translated with no attention to what it would look like in Arabic.

> "The main advantage of this [self-administration questionnaire] is that the researcher or a member of the research team can collect all the completed responses within a short period of time" (p. 236).

The distribution process took place in the period early January 2013 till February 2013 during which time 193 copies were given to various stakeholders of the Libyan Commercial Banks. The researcher had the benefit of a helpful network that had been developed over the previous years from the audit profession; a number of potential respondents were personally known to the researcher, or are currently, or were, clients for either audit or non-audit services of the office where the researcher works[93]. In addition, some of respondents offered to help to distribute more copies of the questionnaire to their own colleagues who worked in the same place and also to contacts in other banks. The procedure with other stakeholders was largely the same. Regulators from the Central Bank of Libya, for example, were accessed through a family member who works for the bank in a non-accounting position, as well as through the manager[94] of the Benghazi branch of the central bank of Libya who is known to the researcher and who was of great assistance when asked to contact more employees to encourage their participation in the survey. Personal contacts were also useful in getting co-operation from the tax authority, the Libyan Stock Market, external auditors, academics and other stakeholders.

In total 193 questionnaires were distributed and collected personally. Questionnaires were attached to a covering letter (English and Arabic versions are included in Appendices 7.1 and 7.2 together with the questionnaires) stating the purpose of the study and encouraging the participants to take part in it; it also identified the researcher and assured the anonymity and confidentiality of any information which respondents would provide.

[93] Efforts were given to ensure that those who were identified as respondents were involved in the financial reporting process e.g. accountant, internal auditor or holding a management position.
[94] He expressed his interest in the research topic and asked more people to contribute in it. He said it was a good opportunity to understand a topic by answering a survey, and the first time he had done this.

Once questionnaires started to come back, the process of coding and keying them into an Excel spreadsheet was started. After feeding all the responses into the spreadsheet, a double check was made to ensure that all responses had been correctly entered. Table 7.1 summarizes the number of returned questionnaires categorized by different stakeholders.

7.3.1 Questionnaire Response Rate

The term "response rate", according to Denscombe (1998), refers to the "proportion of the total number of questionnaires distributed which are completed and returned as requested" (p. 19). It is assumed that not all distributed copies will be returned and be fit for analysis. In this study numerous procedures were followed to help maximize the response rate. This included the questionnaire design and length, layout and question sequencing and wording of questions. In addition the researcher made an effort to get the most from his past experience as an auditor who has a helpful network through job contacts. As shown in Table 7.1 the response rate of this questionnaire was 53%. It varied, amongst the groups of respondents, from 48% for Preparers to 64% for Regulators.

Table 7.1: The Returned Questionnaires

Respondent Groups	Distributed Questionnaires	Returned Questionnaires	Response Rate
Preparers	56	27	48%
Auditors	54	27	50%
Regulators	31	20	64%
Users	52	28	54%
Total	**193**	**102**	**53%**

Note: this Table shows the numbers of distributed and returned questionnaires, as well as the response rate according to each group. More details about the personal information of the respondents are presented in Table 7.2.

7.4 Questionnaire Reliability and Validity

Before getting the data analysed, it is important, according to Field (2009), to "ensure that measurement error is kept to a minimum" (p. 11). For this aim two properties of the instrument should be examined: reliability and validity. Bell (2010), pointed out that both reliability and validity have to be tested regardless of the method used for data collection. He outlined that:

> "Whatever procedure for collecting data is selected, it should always be examined critically to assess to what extent it is likely to be reliable and valid" (p. 119).

7.4.1 Questionnaire Reliability

Reliability refers to an instrument's ability to produce constant and reliable results; a method is considered reliable when if re-used it would produce the same results (Sarantakos, 2005). To Field (2009), reliability refers to the ability to interpret the instrument consistently through different times. In the sense of a questionnaire, a high degree of reliability, according to Gray (2004), means that a researcher should get the same results if the thing being measured is re-measured at some other time[95]; it is a measure of consistency. According to Gray (2004), although reliability can be tested in several ways, one of the most common ways to examine the scale of reliability is Cronbach's alpha test which "presents the average of all possible split-half correlations, and so measures the consistency of all items" (p. 208). The value of Cronbach's alpha is interpreted using a scale from 0 to 1.0; the higher the coefficient, the more reliable the data is (Gray, 2004). This test, according to Saunders et al. (2012), is used to measure the response consistency among the questions; its values range between 0 and 1.0 where a scale of 0.7 or above is considered as acceptable. The Cronbach's alpha for this study has been calculated by SPSS and the generated score was 0.922 which is, according to the above recommendations, acceptable.

7.4.2 Questionnaire Validity

Once the reliability of the instrument is accomplished, its validity should be examined. A reliable method does not mean that it is valid instrument; an instrument's validity should also be tested. Validity is arguably a more complex concept; a valid instrument, according to Bell (2010), is an instrument that measures what it is supposed to measure (Bell, 2010). Sarantakos (2005) defined validity as:

[95] Subject, presumably, to any changes in perceptions in the intervening period that may have been caused by changes in the respondents' environment in relation to the subject matter of the questionnaire.

> "The property of a research instrument that measures its relevance, precision and accuracy… it is a measure of the quality of the process of measurement, and one that reflects the essential value of a study, and which is accepted, respected, and indeed expected by the researchers and users of research" (p. 83).

To test for an instrument's validity, it is suggested that it should be pre-tested before conducting the research (Saunders et al., 2012). In the current study, the validity of the questionnaire was examined for validation by a number of academics and professionals who were targeted in the pilot study as outlined earlier in this chapter.

7.5 Questionnaire Analysis

It was explained earlier in this chapter, that questions were derived from the interview findings, as well as from previous literature. For example, possible earnings management motivations were listed in light of what respondents indicated during the interviews. The questionnaire was designed to be answered by all stakeholders which, for the analysis process, were categorized into four groups: Preparers, Auditors, Regulators, and Users (see Table 7.1).

Once the responses were coded into an Excel spreadsheet as discussed earlier, the data was transferred to the SPSS statistical package for analysis. This study focuses on different stakeholders' perceptions regarding the earnings management practices in Libyan Commercial Banks; for this purpose, most questions were designed based on five-point Likert scales which suggests using non-parametric statistical tests due to the ordinal nature of the qualitative date (Saunders et al., 2012). Determining the statistical tests to be used is based, according to Anderson et al. (2010), on the scale of measurement used in the survey. They indicate that:

> "One consideration in determining whether a parametric or a non-parametric method is appropriate is the scale of measurement used to generate the data" (p. 728).

Therefore, non-parametric tests will be employed in this study, in particular the Kruskal-Wallis (KW) and Mann-Whitney (MW) tests. The KW test is used to identify whether any significant difference exists among the perceptions of the groups; if so, a MW test is carried out to determine which pairs of groups show significantly different perceptions. For further illustration, descriptive statistics, means and standard deviations[96], were also calculated to provide more insightful pictures of the perceptions.

As previously reported in this chapter, the majority of the questions were based on 5-point Likert scales ranging from (1) strongly disagree (SD) to (5) strongly agree (SA). The findings discussion will be restricted only to those which have p-values of 0.05 or under.

7.5.1 Personal Background of the Respondents

The first part of the questionnaire deals with general personal information about the respondents. This part's questions dealt with respondents' age, gender, professional qualification as well as their education and where it took place. It also sought information about any particular experience that a respondent might have had within the banking sector. Table 7.2 summarises the personal information about the respondents corresponding to their groups.

The total proportions of each individual group (Preparers, Auditors, Regulators, and Users) are 26.5%, 26.5%, 19.6%, and 27.5% respectively; most are male (90 out of 102 or 88.2%). Twenty eight (27.5%) are professionally qualified, mainly being members of the Libyan Accountants and Auditors Association (LAAA) (24 or 23.5%). Ninety (88.2%) of the respondents have an academic qualification higher than a Diploma which suggests a good basic knowledge of financial issues. Most importantly, 78 (76.5%) of the respondents have indicated that they have banking experience which again gives a reasonable level of

[96] Means and standard deviations are, strictly speaking, not appropriate as measures of ordinal data, but their use is widespread and they arguably have reasonable information content subject to assumptions made about the intervals in the ordinal data.

assurance as regards to obtaining informed views about Libyan commercial banks (LCBs).

Table 7.2: Respondents' Personal Information

Statement	Category	Groups							
		Preparers		Auditors		Regulators		Users	
			%		%		%		%
Age	Less than 25	1	3.7						
	26-30	3	11.1			2	10.0	11	39.3
	31-40	15	55.6	5	18.5	8	40.0	10	35.7
	41-50	4	14.8	11	40.7	9	45.0	7	25.0
	Over 50	4	14.8	11	40.7	1	5.0		
	Total	**27**	**100**	**27**	**100**	**20**	**100**	**28**	**100**
Gender	Male	26	96.3	25	92.6	20	100	19	67.9
	Female	1	3.7	2	7.4			9	32.1
	Total	**27**	**100**	**27**	**100**	**20**	**100**	**28**	**100**
Professional Qualification	LAAA	6	22.2	12	44.4	1	5.0	5	17.9
	ACCA	3	11.1						
	AICPA			1	3.7				
	ICAEW								
	CIMA								
	Others	1							
	Total	**10**	**37.0**	**13**	**48.1**	**1**	**5.0**	**5**	**17.9**
Education	PhD			6	22.2			3	10.7
	Master	2	7.4			4	20.0	7	25.0
	Bachelor	20	74.1	19	70.4	14	70.0	15	53.6
	Diploma	3	11.1	1	3.7	1	5.0	3	10.7
	Other	1	3.7	1	3.7	1	5.0		
	Total	**26**	**96.3**	**27**	**100**	**20**	**100**	**28**	**100**
Location of highest qualification	Libya	23	85.2	20	74.1	19	95.0	25	89.3
	Other Arab country	1	3.7	5	18.5			2	7.1
	UK	2	7.4	1	3.7	1	5.0	1	3.6
	USA	1	3.7	1	3.7				
	Other								
	Total	**27**	**100**	**27**	**100**	**20**	**100**	**28**	**100**
Place of Work	Commercial Bank	27							
	Central Bank of Libya					14	65.0		
	Libyan Stock Market					3	20.0		
	Tax Authority					3	15.0		
	Audit firm			19	70.3				
	State Audit			8	29.6				
	Academic							15	53.6
	Others							13	46.4
	Total	**27**	**100**	**27**	**100**	**20**	**100**	**28**	**100**
Banking Experience	Less 5 years	9	33.3	15	55.6	3	15.0	24	85.7
	5-10	8	29.6	2	7.4	7	35.0	1	3.6
	11-15	3	11.1	2	7.4	4	20.0	2	7.1
	Over 15	7	25.9	8	29.6	6	30.0	1	3.6
	Total	**27**	**100**	**27**	**100**	**20**	**100**	**28**	**100**

Note: LAAA = Libyan Accountants and Auditors Association, ACCA = Association of Chartered Certified Accountants, AICPA = American Institute of Certified Public Accountants, ICAEW = Institute of Chartered Accountants in England and Wales, and CIMA = Chartered Institute of Management Accountants.

7.5.2 The Quality of Financial Reporting and Earnings Management

The objective of this section is to report the respondents' perceptions about the quality of financial reporting in Libya, as well as their awareness of earnings management.

7.5.2.1 Perceptions Regarding the Quality of Financial Reporting

This section reports the sample groups' perceptions about the quality of financial reporting in Libya. Respondents were asked to indicate their level of agreement or disagreement with a set of statements about the quality of financial statements. At first, the K-W test was performed to highlight any differences between the groups towards the financial quality question. The responses are summarized in Table 7.3 (Panel A). It should be noted that the statements shown are abbreviated versions of the statements on the full questionnaire, see Appendix 7.1.

Table 7.3: Financial Reporting Quality: Perceptions of the Groups
Panel A: Group Means, Standard Deviations, and K-W test

Q	Statement	N	Overall Mean	SD	Group Means				K-W P-value
					PR	AD	RG	US	
2.1.1	Financial reporting is generally good	99	2.75	1.063	3.22	2.88	2.68	2.21	**.005***
2.1.2	Financial reporting of listed companies is good	101	3.03	0.984	3.37	3.07	2.95	2.71	.051
2.1.3	Financial reporting is generally good for banks	101	3.20	1.000	3.41	3.41	3.11	2.86	**.044***
2.1.4	Financial reporting is good for listed banks	100	3.23	0.973	3.41	3.22	3.06	3.18	.478
2.1.5	Listed banks provide relevant information	101	3.32	0.927	3.44	3.41	3.32	3.11	.463
2.1.6	Listed banks provide reliable information	100	3.11	0.863	3.15	3.11	3.16	3.04	.908

Note: This table shows the mean and standard deviation (SD) for all respondents regarding questions about financial reporting quality. It also provides the mean for each group and the p-value for the Kruskal-Wallis (K-W) test. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. A * indicates significance at the 5% level. A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

The overall results presented in Table 7.3 (Panel A) show that, in aggregate, most of the groups agreed with most of the statements. The test shows that two significant differences in respondents' perceptions relate to the first and third questions. While Preparers, who, as may be expected, in aggregate showed agreement with all the questions by giving means above the mid-point 3, perceive financial reporting quality in Libya as good by giving it a mean score of 3.22, the other groups have different views. In particular, the Users group, for example, has a mean score as low as 2.21 indicating that they perceive the quality of financial reporting in Libya to be of low quality. The second question sought to explore views of the same question regarding listed companies; in other words, it allowed them to put forward a view of whether the quality of financial reporting of listed companies was perceived to differ from those that were not listed. Again the respondents come to different views. The Preparers and Auditors perceived listed companies to produce in aggregate good quality financial reporting whereas Regulators and Users, in aggregate, stand on the other side. This may indicate that both Preparers and Auditors believe that the Libyan Stock Market (LSM) requirements play a role in enhancing financial reporting quality, given that the LSM requires listed companies to adopt International Financial Reporting Standards (IFRS) when preparing financial statements. The third question also shows different perceptions between the groups, apparently, as all the groups except Users generally believe that, on balance, listed banks produce financial reporting of good quality.

Apparently, Users do not perceive financial reporting for Libyan companies, listed companies and banks in a favourable light; for each question they answered, the mean is less than 3.00. However, Users tend, on balance, to believe that the financial reporting of listed banks in Libya is of good quality and provides relevant and reliable information (Table 7.3, Panel A, Q 2.1.5 and 2.1.6).

The results reported in Table 7.3 are inconsistent with the interview findings reported in Chapter 6 which indicate that 57% of interviewees perceive the quality of financial reporting as not good; based on the overall mean scores, the questionnaire respondents view the financial reporting quality as good for both banks in general and listed banks in particular (their mean scores of 3.20 and 3.23 respectively for Q 2.1.3 and Q 2.1.4, Table 7.3). Moreover, questionnaire respondents, on average, showed an agreement with the statement that listed banks do provide both relevant and reliable information. Based on the questionnaire results, the accountability of Libyan Commercial Banks either listed or unlisted may be viewed as favourable.

Focusing on the subject of this study, earnings management by LCBs, all groups, excluding Users, believe, in aggregate, that LCBs provide financial information of good quality, which may potentially reflect these stakeholders groups' perception of the accountability of LCBs. On the other hand, all groups, including Users, believe that listed banks provide financial reporting that is relevant and reliable. From an accountability perspective, and based on the results reported in Table 7.3 (Panel A and B), one would judge that all stakeholders groups are satisfied with the accountability mechanism employed by LCBs. However, some stakeholders have shown their disagreement with respect to some of the above issues; for example, the questionnaire responses from Preparers (see Appendix 7.3) indicates that 5 Preparers (out of 27) are not in agreement that LCBs provide good quality financial reporting; 3 these are strongly disagree. Also, not all stakeholders believed that LCBs provide relevant and reliable information as some Preparers suggested that LCBs do not provide relevant and reliable financial information (4 and 6 out of 27 respectively). Another notable difference is that although the Users group showed, on average, a level of agreement with the view that listed LCBs produce financial reporting that involves relevant and reliable information, some of them in strong disagreed with this perception. The questionnaire responses from Users (Appendix 7.6) reveals that 10 Users disagreed with the statement that LCBs financial reporting is of good quality (2 of which strongly disagreed), and other Users expressed their disagreement with the notion that listed LCBs' financial reporting is of good quality (Q 2.1.4), and provides relevant (Q 2.1.5) and reliable (Q 2.1.6) information. The total numbers of Users expressing these opinions were 8, 9, and 6 respectively.

Another test was performed to examine whether stakeholders groups may have different views regarding the quality of financial reporting. Table 7.3 (Panel A) shows that the K-W test scores reveal that significant differences exist between the perceptions in questions Q 2.1.1 and Q 2.1.3 (Table 7.3, Panel A). In order to identify which pairs have significant differences six MW tests have been performed; Table 7.3 (Panel B) presents the results of these tests.

Table 7.3: Financial Reporting Quality: Perceptions of the Groups
Panel B: K-W and M-W tests

Q	Statement	K-W P-values	M-W p-values					
			PR-AD	PR-RG	PR-US	AD-RG	AD-US	RG-US
2.1.1	Financial reporting is generally good	**.005***	.187	**.048***	**.001***	.491	**.023***	.069
2.1.2	Financial reporting of listed companies is good	.051	.146	**.020***	**.013***	.486	.263	.593
2.1.3	Financial reporting is generally good for banks	**.044***	.924	.150	**.023***	.145	**.022***	.415
2.1.4	Financial reporting is good for listed banks	.478	.412	.116	.363	.365	.798	.640
2.1.5	Listed banks provide relevant information	.463	.744	.542	.177	.657	.201	.475
2.1.6	Listed banks provide reliable information	.908	.786	.931	.512	.948	.657	.593

Note: This table shows the p-values produced by M-W test between the different groups regarding questions about financial reporting quality. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. A * indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

The M-W test between Preparers and Regulators groups shows significant differences, they differently perceive the quality of financial reporting in Libya and the financial reporting quality of listed companies. This result may not be unexpected, as preparers normally would defend the quality of the financial reporting which they produce. On the other hand, Regulators (CBL, LSM, and Tax authority) whose job is to inspect and make judgments based on their inspection[97] (which suggests a good knowledge of the quality of financial reporting) expressed views that significantly disagreed with Preparers which is potentially concerning to other stakeholders.

The differences in perceptions are also evident, perhaps unsurprisingly, between the Preparers and Users groups in three questions. The Auditors and Regulators groups show no significant differences. On the other hand, Auditors and Users are different in two places; the first and third questions. Users groups also view the financial reporting quality in Libya differently compared to Regulators. It is notable, as Table 7.3 (Panel B) shows,

[97] The tax authority, for instance, performs an inspection of a bank's financial statements in order to judge the tax charge.

that the Users group expressed significantly different responses in relation to these questions.

M-W tests show that the views of Preparers and Auditors differ significantly for certain questions from the views of Users with the Preparers and Auditors perceiving listed banks' financial reporting as on balance 'good' and Users disagreeing with this notion. The difference between Preparers and Users is particularly notable given that is significant at the 0.1% level.

As discussed above all stakeholders, except Users, agreed, on average, that LCBs' financial reporting in general is of good quality, however, as discussed in Chapter 2, there are no local accounting standards in Libya and accounting practices are mainly dependent on local laws and regulations. This apparent conflict, may be due to a lack of awareness by some stakeholders about the topic of earnings management and its implications for financial reporting.

Also, listed LCBs' financial reporting was, on balance, thought by all stakeholders to be of good quality and it was agreed that listed LCBs provide both relevant and reliable financial information. This may indicate that the LSM requirements have had an impact on the listed LCBs' financial reporting from the stakeholders' point of view. Whether LSM requirements have an effect on LCBs' financial reporting is examined later on in this Chapter. It could also be argued, based on this result, that earnings management may not be practiced by LCBs. The next section examines in more detail the stakeholders' awareness and understanding of earnings management; the perceived effect of earnings management on the quality of financial reporting is also examined in order to gain some understanding of the current level of financial reporting quality of LCBs.

7.5.2.2 Perceptions Regarding Awareness and Understanding of Earnings Management

Respondents were asked to indicate their familiarity with the term “earnings management” (Q 2.2[98]). Only 86 respondents answered this question; 57 (66%) of them indicated that they had heard of the term while only 29 (34%) of them answered that they have not heard of the term. This result is not in line with the interview findings reported in Chapter 6, which showed that the majority of the interviewees had not heard of the term “earnings management”. The interview findings also indicated that the term “earnings management” is confusingly interpreted.

Table 7.4: Respondents Familiarity with the Term Earnings Management

Respondents	Answer	%
57	Yes	55.9[99]
29	No	28.4[100]

Note: This table presents the respondents answer to the question 2.2 “Are you familiar with the term earnings management”.

The result is also not consistent with the findings reported in earlier questions where most stakeholders showed some agreement with the view that LCBs’ financial reporting is of good quality. However, respondents’ claim that they recognise the term “earnings management” may conceal differing views about the meaning of the term. The next question in this section (Q2.3) listed three of the most common interpretations that interviewees offered as well as a very brief definition of earnings management as widely understood in the accounting literature. At first, a K-W test was performed to ascertain if there is any significant difference between the groups regarding their understanding of the term “earnings management”. Table 7.5 (Panel A) summarises the responses of the surveyed groups.

[98] As discussed in Chapter 6, the Arabic translation for the term ‘earnings management’ is the one that is in wide use in a number of Arabic speaking countries.
[99] This percentage represents those who answered ‘Yes’ (57) to the overall respondents (102).
[100] This percentage represents those who answered ‘No’ to the overall respondents (102).

Table 7.5: Respondents Perceptions about the Meaning of Earnings Management
Panel A: K-W test

Q	Statement	N	Mean	SD	Group Means				K-W P-value
					PR	AD	RG	US	
2.3.1	Reinvesting the earned profits	92	3.23	1.110	3.13	3.62	3.47	2.76	**.044***
2.3.2	Manipulating earnings	93	3.18	1.233	3.20	3.08	2.88	3.48	.358
2.3.3	A department responsible for planning and controlling the reported income	91	3.20	1.024	3.48	3.12	3.18	3.00	.515
2.3.4	Increasing or decreasing income according to management's desire	95	3.41	.995	3.36	3.12	3.33	3.81	.084

Note: This table shows the mean and standard deviation (SD) for all respondents regarding questions about earnings management meaning . It also provides the mean for each group and the p-value for the Kruskal-Wallis (K-W) test. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. A * indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

The first question (Q2.3.1, Table 7.5, Panel A) asked whether earnings management refers to management reinvesting its income. The results reveal that all groups, except Users, agreed that earnings management held the meaning of reinvesting the earned profits. The K-W test also indicated a significant difference in perceptions regarding this question; it is evident that the Users group holds an extreme view compared to all other groups by only looking at the groups' means. The K-W test did not show any other differences suggesting no other significant disagreement between the groups, however, again by looking at the groups' means, it is apparent that Regulators perceive that the link to earnings manipulation is different as their mean (2.88) answer to the 2nd question would suggest. Unlike other groups, the Regulators groups do not perceive earnings management as being earnings manipulation. In this regard it is worth noting the questionnaire responses by Regulators only in respect to this statement: 17 out of 20 Regulators have answered this questions and their answers were as follows; 7 disagree, 3 of whom are strongly disagree and 7 agree only one of whom is strongly agrees; 3 Regulators gave neutral answers to these questions. Given this fact, there is no total disagreement with the answers of other groups to this question; rather Regulators had an equal attitude toward it.

The mean scores of the remaining questions (2.3.3 and 2.3.4) show a broad level of agreement with the statements among all the groups regarding these questions since all of them are above the mid-point 3. Although all groups' means are above the mid-point, it is noticeable that the Preparers group has the highest mean score (3.48) in agreeing that earnings management is a bank department that is responsible for the planning and controlling of income; this is potentially due to the fact that the term "management" is being mistakenly interpreted as a department. The last question (2.3.4) gave a brief description of earnings management behaviour to which all groups agreed as the mean scores suggest. Although this result may show that all groups are aware that such a meaning refers to earnings management it is noteworthy that the Users' mean score is the highest (3.81). This could be partially due to the fact that this group consisted of 15 academics out 28, since academics are expected to have knowledge about such a financial reporting issue.

As outlined earlier, a number of the questionnaire questions were drawn from the interviewees' answers, as in the case of the first three questions have. A brief definition of the term 'earnings management' was inserted in case a respondent was unsure about what earnings management could mean; this was in Questions 2.3.4 (Table 7.5). The respondents were in agreement, on balance, that earnings management implies that management desire to alter the reported income by giving this statement a mean score of 3.41. This result is not in line with the interview findings reported in Chapter 6 (Table 6.4) which revealed that 79% of interviewees have not heard of the term 'earnings management'.

The second stage was to perform 6 M-W tests to identify which two pairs of groups perceive the questions differently; the results are shown in Table 7.5 (Panel B).

Table 7.5: Respondents Perceptions about the Meaning of Earnings Management
Panel B: M-W test

Q	Statement	K-W P-values	M-W p-values					
			PR-AD	PR-RG	PR-US	AD-RG	AD-US	RG-US
2.3.1	Reinvesting the earned profits	**.044***	.138	.390	.296	.636	**.006***	.059
2.3.2	Manipulating earnings	.358	.684	.423	.327	.677	.174	.117
2.3.3	A department responsible for planning and controlling the reported income	.515	.159	.360	.240	.852	.940	.753
2.3.4	Increasing or decreasing the income according to management's desire	.084	.375	.793	.106	.476	**.020***	.078

Note: This table shows the p-values produced by M-W test between the different groups regarding questions about earnings management meaning. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. A * indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

Although, the K-W test reveals that there is only one significant difference between the groups, the M-W test refers to two significant differences existing between Auditors and Users regarding the first and last questions. It is shown in Table 7.5 (Panel A) that the Auditors' mean score (3.62) for the first question is the highest suggesting that their agreement with the view that earnings management is the reinvesting of profits is more strongly held; the users group had the lowest mean score (2.76) for this question. As for the last question, the difference can also be explained by looking at the mean scores in Table 7.5 (Panel A) which highlight that users (3.81) are more strongly of the view that earnings management is the behaviour of increasing and decreasing income as per management's desire than other stakeholders. As discussed earlier, this could be because most of the Users are academics. The Auditors' score is the lowest for this question (3.12) although it is above the mid-point. It could potentially be perceived as an issue of concern by other stakeholders given the importance of the role of the external auditor in the financial reporting process. Stakeholders, arguably depend on the external auditor when making economic decisions so his/her knowledge might be expected to be higher than any other related group. However, it is worth nothing that the Auditors group consisted of 27 individuals of which only 13 are professionally qualified (see Table 7.2). In addition the questionnaire responses by Auditors shows that 11 Auditors agreed to this statement and 9

Auditors did not agree. Another important point in regard to the Auditors group, is that the majority have less than 5-years work experience in a bank which may imply that they have limited knowledge about such issues.

At this stage, all respondents were given an earnings management definition so that the remaining responses are reasonably comparable by ensuring that respondents have about the same understanding of the meaning of the term earnings management.

7.5.2.3 Perceptions about Earnings Management in Relation to Various Issues

This section explores various issues relating to earnings management. First of all it asks about the implications of earnings management in relation to the quality of financial statements. Then four questions are asked to investigate whether there is a difference between private and public banks, and between listed and unlisted banks in terms of the application of earnings management. Afterwards, the underlying reasons of why bank managers would engage in earnings management are investigated. Table 7.6 (Panel A) presents the responses relating to these questions

Table 7.6: Stakeholders' Perceptions about the Practice of, and Motivations for, Earnings Management
Panel A: K-W test

Q	Statement	N	Mean	SD	Group Means				K-W
					PR	AD	RG	US	P-value
2.4.1	Earnings management affects the quality of financial statements	99	3.96	.768	3.81	4.00	3.94	4.07	.734
2.4.2	Earnings management is practiced by private listed banks	98	3.35	.932	3.62	3.19	3.44	3.18	.101
2.4.3	Earnings management is practiced by private unlisted banks	97	3.31	.755	3.32	3.38	3.33	3.21	.822
2.4.4	Earnings management is practiced by public listed banks	94	3.11	.861	3.00	3.04	3.31	3.14	.622
2.4.5	Earnings management is practiced by public unlisted banks	93	3.01	.787	2.84	2.87	3.17	3.19	.331
2.4.6	Managers exercise earnings management to manipulate information communicated to shareholders	96	3.02	1.036	2.62	3.15	3.11	3.23	.166
2.4.7	Managers exercise earnings management for their own benefits	98	3.16	1.012	2.73	3.12	3.56	3.36	.058
2.4.8	Earnings management enables managers to better communicate economic information to stakeholders	97	2.74	1.044	2.65	2.76	3.06	2.61	.526
2.4.9	Managers exercise earnings management to manipulate information to regulators	97	3.22	1.033	3.04	2.96	3.39	3.50	.201
2.4.10	Managers exercise earnings management to manipulate information communicated to credit rating agencies	97	3.19	1.024	3.08	3.00	3.39	3.33	.524

Note: This table shows the mean and standard deviation (SD) for all respondents regarding questions about various issues related to earnings management . It also provides the mean for each group and the p-value for the Kruskal-Wallis (K-W) test. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. A * indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

Stakeholders expressed a broad level of agreement, based on their mean scores, on the first four issues (Q 2.4.1- 2.4.4). All stakeholders agreed, in aggregate, that earnings management practices affect the quality of financial statements; they also showed similar scores regarding the practice of earnings management by private banks; they perceived that earnings management is practiced by private banks no matter whether they are listed or unlisted. Earnings management is also perceived by each stakeholder group to be practiced by public listed banks. Unlisted banks are, in aggregate, only perceived by the Preparer and Auditor groups not to be engaged in earnings management practices; this may suggest that from the view point of these two groups there is an influence by the Libyan Stock Market on the public banks. However, it worth noting in detail the questionnaire responses only by Auditors; the total number of Auditors who responded to this question is 23 (out of 27) the majority of whom (15 out of 23) expressed a neutral attitude; 5 disagreed and only 3 agreed with the statement. Given that the majority of Auditors who answered this question neither agreed nor disagreed with the statement that listed public banks are engaged in earnings management, the overall opinion of Auditors in respect of this issue may not be clear.

The other two groups (Regulators and Users) seem to perceive that earrings management is practiced by public banks regardless of whether they are listed or not. That is similar to their views regarding private banks. Some underlying reasons as to why bank managers may be involved in earnings management practices are discussed in the remaining six questions of Table 7.6 (Panel A and B). Questions as to whether bank managers exercise earnings management practices to mislead or satisfy shareholders or for their own benefits show different perceptions between the Preparers group and other groups. While Preparers tend to believe, on average, that bank managers do not engage in earnings management to either affect the shareholders or for their own benefit, other groups think that bank managers exercise earnings management for these reasons. This result suggests that, from the view point of Auditors, Regulators, and Users, bank managers are involved in what is called "opportunistic earnings management" where managers engage in earnings management for their own benefit. The other type of earnings management is "informative earnings management" where bank managers manage earnings so as to better communicate the economic and financial situation of the bank. Notably, only the Regulators group think, on average, that this type of earnings management is practiced by the bank managers while other groups' mean scores are at the mid-point suggesting that, on balance, they do not think that this type of earnings management exists within Libyan Commercial Banks. Whether earnings management does exist to affect the information communicated to regulators is only doubted by the Auditors group although their mean score is very close to the mid-point (2.96). However other groups' mean scores are over 3.00 confirming that, there is, on balance, a perception that earnings management could be practiced to send misleading information to regulators. Lastly, all groups agreed, on balance, that earnings management is practiced in order to affect the bank rankings supplied by the credit rating agencies.

Table 7.6 reveals some contradict results. On one hand, it shows a relatively wide level of agreement, that earnings management has a negative effect on the quality of financial reporting and confirms, on balance, that earnings management is practiced by LCBs. This may conflict with the results reported previously in Table 7.3 which suggest that the financial reporting quality of LCBs is good and that listed banks do provide relevant and reliable information.

Although the Kruskal-Wallis test does not show any significant differences between the stakeholder groups, the Mann-Whitney test results in Table 7.6 (Panel B) shows that there are three significant differences; the first two are between the Preparers and Users groups, the third is between the Preparers and Regulators groups. Preparers and Users show a significant difference in views regarding the practicing of earnings management by private listed banks. Although both groups think, on average, that private listed banks are engaged in earnings management, the Preparers' mean score is slightly higher than Users': 3.62 and 3.18 respectively. Also, the Preparers group thinks that earnings management is not practiced to influence the shareholders; by contrast, the Users group believes that earnings management is practiced for such a reason. This result is in line with many findings reported in Chapter 6; that a trust issue does exist between the Preparers and some other groups. The second significant difference occurred between the responses of the Preparers and Regulators groups; while the former think, on balance, that opportunistic earnings management does not exist, Regulators think, on average, that this type of earnings management does exist giving further evidence of a significant disagreement that refers to trust; this conflict has implications for the extent to which accountability can be seen to exist. Perceptions relating to accountability are explicitly considered in the next subsection.

Table 7.6: Stakeholders' Perceptions about the Practice of, and Motivations for, Earnings Management
Panel B: M-W test

Q	Statement	K-W P-values	M-W p-values					
			PR-AD	PR-RG	PR-US	AD-RG	AD-US	RG-US
2.4.1	Earnings management affect the quality of financial statements	.734	.497	.426	.360	.788	.788	.821
2.4.2	Earnings management is practiced by private listed banks	.101	.073	.548	**.038***	.193	.848	.120
2.4.3	Earnings management is practiced by private unlisted banks	.822	.915	.964	.544	1.000	.386	.472
2.4.4	Earnings management is practiced by public listed banks	.622	.872	.296	.602	.257	.773	.323
2.4.5	Earnings management is practiced by public unlisted banks	.331	.852	.249	.186	.177	.174	1.000
2.4.6	Managers exercise earnings management to manipulate information communicated to shareholders	.166	.095	.114	**.045***	.965	.717	.686
2.4.7	Managers exercise earnings management for their own benefits	.058	.240	**.015***	.053	.096	.426	.373
2.4.8	Earnings management enables managers to better communicate economic information to stakeholders	.526	.721	.242	.850	.447	.540	.153
2.4.9	Managers exercise earnings management to manipulate information to third party regulators	.201	.749	.337	.158	.152	.056	.721
2.4.10	Managers exercise earnings management to manipulate information communicated to credit rating agencies	.524	.746	.404	.460	.219	.240	.833

Note: This table shows the p-values produced by M-W test between the different groups regarding questions about different issues related to earnings management. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. A * indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

It is worth noting here that the thinking behind asking the questions (2.4.2 and 2.4.3) and (2.4.4 and 2.4.5) is to examine the affect, if any, of the LSM's requirements on financial reporting quality. It may be assumed that such requirements may put pressures on LCBs' managers to produce financial report in a certain way. It may also be assumed, based on such requirements, that list LCBs' managers are potentially held more accountable relative to their unlisted LCBs counterparts. However, the results, as reported above, showed, on average, that the LSM had a slight impact on LCBs' financial reporting. The accountability of LCBs' managers are examined in the next section.

7.5.2.4 Perceptions Regarding the Accountability of LCBs' Managers

This section investigates to whom LCBs' managers are held accountable. The interview findings suggest that bank managers are thought, to a large extent, to be accountable to shareholders as the interview findings indicated that 75% of interviewees perceived LCBs' shareholders as the main stakeholder for LCBs. However, some other stakeholders were mentioned during the interviews; these stakeholders along with some others have been included in this question (Q 2.5) to identify the extent to which respondents agree that bank managers are seen as being accountable to a list of stakeholders. The reason behind this question was to examine the extent to which a narrow or wide notion of accountability exists in LCBs. This may inform the thesis about the accountability system of LCBs. The results are presented in Table 7.7 (Panel A), and show no significant differences in perceptions according to a Kruskal-Wallis test performed to investigate whether any significant variation occurs between the responses of the various stakeholders groups

Table 7.7: Stakeholders' Perceptions about LCBs' Accountees
Panel A: K-W test

Q	Statement	N	Mean	SD	Group Means				K-W P-value
					PR	AD	RG	US	
2.5.1	Shareholders	102	3.94	.818	4.00	4.07	3.90	3.79	.531
2.5.2	Employees	102	2.91	1.082	2.78	2.85	2.75	3.21	.343
2.5.3	Current and potential customers	101	3.48	.901	3.52	3.56	3.25	3.52	.467
2.5.4	Central Bank of Libya	101	4.17	.788	4.26	4.07	4.00	4.29	.592
2.5.5	Tax authority	98	3.83	.813	3.84	3.69	3.79	3.96	.325
2.5.6	The Libyan Stock Market	100	3.76	.806	3.73	3.81	3.65	3.82	.914
2.5.7	Corresponding banks	99	3.63	.803	3.88	3.73	3.50	3.39	.136
2.5.8	Bank credit rating agencies	100	3.54	.892	3.56	3.63	3.60	3.39	.734
2.5.9	Media	101	3.00	1.020	3.15	3.11	3.10	2.68	.337
2.5.10	Academia and research centers	100	2.85	.999	3.04	2.92	2.95	2.54	.284
2.5.11	Society as a whole	99	2.84	.987	3.12	2.74	3.00	2.57	.212

Note: This table shows the mean and standard deviation (SD) for all respondents regarding questions about whom bank managers are accountable to. It also provides the mean for each group and the p-value for the Kruskal-Wallis (K-W) test. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. A * indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

The results presented in Table 7.7 (Panel A) reveal a relatively strong level of agreement from the questionnaire respondents as to whom the LCBs' managers are accountable. However, questionnaire respondents consider that employees (Q 2.5.2), academia and research centres (Q 2.5.10), and society as a whole (Q 2.5.11) are, on balance, not considered as LCBs' accountees with the overall mean scores for these accountees being; 2.91, 2.85, and 2.84 respectively. It is notable from the mean scores reported in Table 7.7 (Panel A) that the Users group has a different view in regards to whether employees are accountees for LCBs in contrast to the Preparers, Auditors, and Regulators groups who, on average, disagreed with this statement. This may, partially, be due to normative ideas held by academics who represent 53% of the Users group. Also, revisiting the questionnaire responses by individual groups give us some indications that are worth noting. For example, the questionnaire responded by Preparers (Q 2.5, Appendix 7.3) shows that 8 (out of 27) Preparers agreed that employees are regarded as one of LCBs' accountees; it is also worth noting that 4 of these strongly agreed with this statement. On the other hand, although the Auditors group, on average, disagreed that employees are LCBs' accountees, a more detailed analysis reveals (in their group's responses, Appendix 7.4) that 8 (out of 27) agreed with the statement about employees being an LCBs' accountee. It should again be noted that only 13 (out of 27) of Auditors are professionally qualified. However, no significant difference appeared between qualified and non-qualified Auditors in this regard[101].

Ironically, the Preparers group think of academia and research centres as an accountee for bank managers while, on the other hand, the Users group (53% of which are academic) disagree, on balance, with that idea (by giving a mean score of 2.54), and so do Auditors and Regulators groups. Another area of disagreement appears when society as a whole was

[101] A M-W test showed no significant difference between professionally qualified and non-professionally qualified Auditors.

suggested as an accountee. The Preparers group agreed with this statement while the Auditors and Users groups disagreed.

As mentioned earlier, interview findings reveal that shareholders were thought of as the main stakeholder group for LCBs (75% of interviewees). This conforms with the results revealed in Table 7.7, as per Q 2.5.1. From this question, it is clear that questionnaire respondents perceive shareholders as accountees to LCBs. It is also notable that the highest mean score of 4.17 in this Table was given to the Central Bank of Libya (CBL, Q 2.5.4). This result suggests a dual role for the CBL in this regard. On one hand, they are the owner of the public banks and on the other hand a regulator for both private and public banks. This may partially justify the high mean score given which suggests that the CBL is the main accountee to LCBs.

To see whether any two groups have any significant differences in perceptions, six Mann-Whitney tests were performed; the results are shown in Table 7.7 (Panel B). It can be seen that the only significant difference exists between the Preparer and User groups despite the fact that both groups agree that corresponding[102] banks are an accountee. However, one might think that the Users group may not have sufficient knowledge and awareness of what “corresponding banks” meant which may suggest a disagreement in responses between both groups.

[102] “Corresponding banks” is a term used within banking sector when a bank is being offered banking services by other bank.

Table 7.7: Stakeholders' Perception about LCBs' Accountees
Panel B: M-W test

Q	Statement	K-W P-values	M-W p-values					
			PR-AD	PR-RG	PR-US	AD-RG	AD-US	RG-US
2.5.1	Shareholders	.531	.991	.419	.269	.369	.214	.842
2.5.2	Employees	.343	.684	.758	.144	.847	.202	.114
2.5.3	Current and potential customers	.467	.915	.161	.863	.188	.956	.244
2.5.4	Central Bank of Libya	.592	.697	.207	.956	.473	.644	.197
2.5.5	Tax authority	.325	.344	.575	.549	.691	.084	.188
2.5.6	The Libyan Stock Market	.914	.917	.739	.773	.625	.871	.488
2.5.7	Corresponding banks	.136	.524	.094	**.039***	.344	.172	.638
2.5.8	Bank credit rating agencies	.734	.855	.888	.464	.992	.335	.386
2.5.9	Media	.337	.828	.975	.113	.933	.181	.165
2.5.10	Academia and research centers	.284	.698	.675	.077	.941	.164	.197
2.5.11	Society as a whole	.212	.170	.598	.060	.506	.450	.168

Note: This table shows the p-values produced by M-W test between the different groups regarding questions about whom bank managers are accountable to. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. A * indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

7.5.2.5 Stakeholders' Perceptions about Earnings Management Motivations

This question (Q 2.6) investigates respondents' opinions about the motivations that induce bank managers to indulge in earnings management practices. Several questions have been listed in this section; these were mainly based on the literature. The questions were split into two groups (state and private) in order to examine whether ownership has any influence over perceived earnings management motivations in the LCBs; they also examined the influence of the Libyan Stock Market's effect on earnings management practices by asking if it was thought to affect the bank's share price. The results are shown in Table 7.8 (Panel A) and reveal a relatively strong level of agreement overall among stakeholder groups for all the questions. This suggests that the listing requirements were perceived to influence bank managers to engage in earnings management practices no matter the type of ownership as state and private banks were seen to be similarly motivated on this issue. More specifically, the Auditors group recorded a slight difference for question (Q 2.6.6) which investigated whether there was any institutional effect on bank managers that encouraged involvement in earnings management practices. They perceived that State owned banks, on average, were not motivated by other banks behaviour (mean score 2.92), and that private banks were, on balance, neutral on this motive; their mean score was 3.00. This result should be considered in light of the fact that most of the

Auditors who responded (14 out of 27) have no professional qualification (see Table 7.2) which therefore, may explain this unexpected response. The questionnaire responses by Auditors only (Appendix 7.4) reveals that Auditors agreed and disagreed with this statement almost equally; as 7 agreed whereas another 7 disagreed and only one Auditor strongly disagreed with this statement. It seems that this Auditor, in addition, to a relatively large amount (11) who gave a neutral responses to this statement, is responsible for the below mid-point mean score (2.92) that was generated by the Auditors group.

As can be noted in Table 7.8 (Panel A), the KW test reveals no significant differences.

Table 7.8: Stakeholders' Perceptions about Earnings Management Motivations
Panel A: K-W test

Q	Statement	N	Mean	SD	Group Means				K-W P-value
					PR	AD	RG	US	
2.6.1.1	Management compensation – state	91	3.37	1.071	3.43	3.26	3.24	3.54	.610
2.6.1.2	Management compensation – private	92	3.73	.939	3.74	3.88	3.50	3.73	.606
2.6.2.1	Job security – state	89	3.43	1.010	3.38	3.33	3.44	3.56	.774
2.6.2.2	Job security – private	92	3.62	.936	3.74	3.72	3.53	3.48	.756
2.6.3.1	To avoid regulatory intervention – state	91	3.42	1.065	3.45	3.37	3.00	3.68	.198
2.6.3.2	To avoid regulatory intervention – private	91	3.51	.935	3.52	3.44	3.47	3.58	.950
2.6.4.1	The desire to report smooth earnings – state	92	3.40	.973	3.40	3.19	3.53	3.54	.305
2.6.4.2	The desire to report smooth earning – private	91	3.52	.886	3.74	3.32	3.44	3.56	.359
2.6.5.1	To influence other stakeholders - state	91	3.16	1.036	3.21	3.04	3.12	3.29	.864
2.6.5.2	To influence other stakeholders – private	91	3.43	1.034	3.52	3.16	3.67	3.44	.376
2.6.6.1	Because other Libyan banks manage earnings – state	89	3.13	.882	3.10	2.92	3.20	3.32	.367
2.6.6.2	Because other Libyan banks manage earnings – private	87	3.26	.982	3.41	3.00	3.29	3.36	.499
2.6.7.1	To avoid reporting losses - state	91	3.59	1.033	3.40	3.56	3.25	3.96	.109
2.6.7.2	To avoid reporting losses – private	88	3.58	1.047	3.55	3.64	3.35	3.71	.885
2.6.8.1	To meet predetermined income – state	90	3.39	1.013	3.57	3.19	3.37	3.44	.562
2.6.8.2	To meet predetermined income – private	88	3.48	.947	3.83	3.29	3.53	3.29	.165
2.6.9.1	To decrease tax payment – state	92	3.29	1.022	3.55	3.04	3.29	3.36	.381
2.6.9.2	To decrease tax payment – private	90	3.71	.939	3.64	3.60	3.82	3.81	.868
2.6.10.1	To influence assessment by credit rating agencies – state	94	3.43	.823	3.48	3.33	3.56	3.39	.706
2.6.10.2	To influence assessment by credit rating agencies – private	89	3.69	.748	3.76	3.56	3.78	3.68	.745
2.6.11.1	To influence stock price – state	93	3.44	1.005	3.48	3.26	3.41	3.61	.678
2.6.11.2	To influence stock price – private	89	3.66	.941	3.86	3.28	3.78	3.80	.112

Note: This table shows the mean and standard deviation (SD) for all respondents regarding questions about earnings management motivation in LCBs. It also provides the mean for each group and the p-value for the Kruskal-Wallis (K-W) test. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. A * indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

The results reported above in Table 7.8 (Panel A) show that the stakeholders' perceptions of the earnings management motivations of LCBs are to large extent consistent with earnings management motivations reported in the literature; for example Management Compensation Contract Incentives, Regulatory and Political Motivations, and Capital Market Motivations (see Section 3.5, Chapter 3). In addition results are consistent with interview findings which refer to 'job security' as the primary motivation for LCBs' managers to engage in earnings management practices. However, in very limited circumstances, some individual groups showed a different perception as discussed earlier (Auditors group's perception in regards to Q 2.6.6.1, Table 7.8, Panel A). However, with the exception of this case, as reported in Table 7.8 (Panel A) the overall mean scores are above the mid-point of 3.00 which indicate a level of agreement among all stakeholder groups about the statements.

Six MW tests were performed to identify any significant differences between any two pairs. The results of these tests are shown in Table 7.8 (Panel B).

Table 7.8: Stakeholders' Perceptions about Earnings Management Motivations
Panel B: M-W test

Q	Statement	K-W P-values	M-W p-values					
			PR-AD	PR-RG	PR-US	AD-RG	AD-US	RG-US
2.6.1.1	Management compensation – state	.610	.424	.409	.785	1.000	.301	.320
2.6.1.2	Management compensation – private	.606	.843	.262	.709	.219	.601	.506
2.6.2.1	Job security – state	.774	.899	.682	.475	.584	.363	.680
2.6.2.2	Job security – private	.756	.936	.546	.387	.598	.402	.821
2.6.3.1	To avoid regulatory intervention – state	.198	.829	.261	.489	.238	.322	**.021***
2.6.3.2	To avoid regulatory intervention – private	.950	.963	.619	.868	.796	.789	.559
2.6.4.1	The desire to report smooth earnings – state	.305	.556	.341	.407	.112	.121	.911
2.6.4.2	The desire to report smooth earning – private	.359	.066	.435	.684	.394	.271	.779
2.6.5.1	To influence other stakeholders - state	.864	.635	.901	.767	.790	.412	.663
2.6.5.2	To influence other stakeholders – private	.376	.221	.547	.938	.074	.341	.613
2.6.6.1	Because other Libyan banks manage earnings – state	.367	.639	.518	.323	.276	.109	.720
2.6.6.2	Because other Libyan banks manage earnings – private	.499	.208	.944	.998	.281	.200	.948
2.6.7.1	To avoid reporting losses - state	.109	.593	.878	**.049***	.452	.120	**.034***
2.6.7.2	To avoid reporting losses – private	.885	.796	.753	.600	.525	.867	.516
2.6.8.1	To meet predetermined income – state	.562	.202	.552	.750	.429	.332	.834
2.6.8.2	To meet predetermined income – private	.165	.056	.211	.064	.410	.893	.520
2.6.9.1	To decrease tax payment – state	.381	.131	.506	.548	.316	.216	.940
2.6.9.2	To decrease tax payment – private	.868	.851	.759	.642	.489	.476	.962
2.6.10.1	To influence assessment by credit rating agencies – state	.706	.581	.701	.746	.239	.840	.387
2.6.10.2	To influence assessment by credit rating agencies – private	.745	.351	1.000	.688	.341	.687	.683
2.6.11.1	To influence stock price – state	.678	.523	.934	.621	.638	.235	.579
2.6.11.2	To influence stock price – private	.112	**.041***	.727	.959	.071	.060	.713

Note: This table shows the p-values produced by M-W test between the different groups regarding questions about earnings management motivation in LCBs. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. A * indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

The MW results reveal four significant differences across the different stakeholder groups. First of all, the Preparer and Auditor groups seem to have different views about whether bank managers practice earnings management in order to affect the share prices of private banks. Both groups agreed, on balance, that private LCBs are motivated to practice earnings management in order to influence their share price (Capital Market Motivations). However, a notable difference can be observed by looking at the questionnaire responses for each individual group. It is clear that Preparers stand on the side of agreement given that only 2 Preparers (out of 21 who responded to this statement) selected the disagreement option. On the other hand it is less obvious where Auditors are standing. Although 11 Auditors (out 25 who responded to this statement) expressed agreement with the statement, 2 of which strongly agreed, six (out of 25) disagreed with the view that private LCBs engage in earnings management. The reason why the Auditors' attitudes may not be that clear could be that 8 Auditors selected the neutral response. The response of the Auditor group, in this study, should also be treated with caution in light of the fact that only 13 (out of 27, the total number of Auditors group) are professionally qualified. Therefore, some of Auditors (the remaining 14) may lack the expected experience to answer the questions. For example, they may not have dealt with this statement, and others, with appropriate 'professional scepticism' and therefore, their answers may not be consistent with the rest of the Auditor sample[103].

The second significant difference relates to the Preparer and User groups regarding whether State owned banks manage earnings in order to avoid reporting losses. Again this difference should be looked at in light of how the questionnaires were answered by each group individually. Preparers showed, on average, a level of agreement with the view that state banks may engage in earnings management in order to avoid reporting losses with no a single Preparer expressing a strong level of disagreement with this statement. In addition, a relatively large number of Preparers did not respond to this statement (7 out of 27) and 6 responded neutrally. This leaves us with only 14 Preparers who showed, on balance, a clear overall attitude; 5 Preparers disagreed, another 5 agreed, and 4 strongly agreed with this statement. As for the Users group, they showed a clear level of agreement with this statement with only one response on the strongly disagree side. It should be noted that all Users responded to this statement; 17 agreed, 6 strongly agreed, and very few (4) selected a neutral response.

[103] No significant difference was found between professional and non-professional Auditors in regards to this statement.

A third significant difference revealed by the MW tests was between the Regulator and User groups as to whether state banks engaged in earnings management in order to avoid any regulator intervention. The Regulators group answered this statement with a neutral mean score while Users were, on average, in agreement with a mean score of 3.68. This significant difference could be, partially, due to the ambiguous attitude of Regulators to this issue; as 6 agreed while only 5 disagreed with the statement, one of which showed strong disagreement. On the other hand, Users' attitudes regarding this statement were more clear in their agreement; the total number of Users who agreed to this statement is 20 including 4 who strongly agreed that state LCBs may be engaged in earnings management to avoid regulatory interventions.

Finally, a significant difference exists between the Regulator and User groups in terms of whether state banks are motivated to manage earnings in order to avoid report losses. The general view of Users in respect of this statement was clearer than the opinion of Regulators. The total number of Users who expressed a level of agreement with this statement is 23 of which 6 strongly agreed with the notion expressed. On the other hand, only 9 Regulators agreed with the statement (one of which strongly agreed) while a relatively significant number (4) of Regulators disagreed to this statement 2 of which strongly disagreed.

There is a wide spread level of agreement amongst stakeholder groups that most of the listed motivations are perceived as potentially motivating LCBs to engage in earnings management practices. The Auditor who gave this statement a mean score of 2.92 (for Q 2.6.6.1 Table 7.12) apparently did not believe, on average, that a public commercial bank would be inspired by other banks' behaviours to engage in earnings management. Also the Auditors group appeared neutral in relation to a similar question relating to private banks (Q 2.6.6.2 Table 7.12) as their mean score was 3.00.

This general level of agreement could reflect stakeholder groups' beliefs that such motivations, when they exist, represent threats to the accountability relationship of LCBs regardless of whether they are public or private, or listed or unlisted. An LCB manager may not be seen to be properly accountable when such motivations exist.

7.5.2.6 Perceptions about Earnings Management Tools

This section identifies to what extent stakeholders agree regarding the techniques which might be used by bank managers to alter reported income. The respondents were asked to indicate their agreement or disagreement regarding the effectiveness of some potential earnings management techniques which were referred to during the interviews. The Kruskal-Wallis test was conducted, at first, to identify any significant differences between stakeholders groups. The test results are presented in Table 7.9 (Panel A). With few exceptions, most stakeholders groups' perceptions showed similar means, and most of them indicated their agreement with the potential usage of the earnings management methods listed in Table 7.9 (Panel A). More specifically, reserves (Q 2.7.1) are accorded the highest mean (3.71) suggesting it as potentially the most likely method to be used by bank mangers to change their firms' reported income. It has to be mentioned that the term 'reserves' does include, inter alia, the Loan Loss Provision (LLP) which was mentioned a lot during the interviews. However, in this questionnaire the LLP is separately examined as will be discussed later.

The lowest mean score was given to foreign currency (Q 2.7.8) and this was because of different views held by the Auditors group regarding this question; apparently auditors, on balance, do not agree that foreign currency may be used for earnings management by LCBs as their mean score was only 2.88. Another two areas of disagreement were in Q 2.7.5 and Q 2.7.9 which both had the same overall mean score of 3.33. Concealing losses (Q 2.7.5) which means that bank managers may not register transactions in a timely fashion could have an adverse impact on the reliability of the reported income e.g. failing to book a huge amount of expenses in the current period. For this question, most stakeholders agreed in aggregate that such a tool could be used for earnings management; the exception was the Preparers group that was non-committal since it only gave this question a mean score of 3.00. The third area of disagreement was about the manipulation of the loan loss provision (LLP) (Q 2.7.9). In this question, the mean score of the Preparers group, on balance, suggests doubt about whether the LLP could be used for earnings management purposes; but all the other stakeholders groups agreed with the view that it could as indicated by the mean scores. However, an overview on the questionnaire responses by Preparers (Appendix 7.3) may be informative; the total number of Preparers who answered this question is 25 (out of 27) and the total number of those who agreed (11) is greater than those that did not agree (9) while 5 gave neutral answers. The reason why the overall mean was below 3.00 is that five of the nine Preparers who disagreed strongly disagreed that LLP could be used as an earnings management tool. As the previous Chapter mentioned, the LLP is one of the provisions a company usually maintains. It, on balance, highlighted by all stakeholder groups (according to the overall mean) to be one of the techniques that LCBs' manager may use since it received the highest mean score of 3.71.

Table 7.9: Earnings Management Techniques
Panel A: K-W test

Q	Statement	N	Mean	SD	Group Means				K-W P-value
					PR	AD	RG	US	
2.7.1	Reserves	99	3.71	.799	3.73	3.73	3.68	3.68	.918
2.7.2	Revenue recognition	97	3.61	.758	3.60	3.54	3.61	3.68	.942
2.7.3	Disposing of high market value assets	100	3.44	.891	3.42	3.26	3.58	3.54	.536
2.7.4	Investments	100	3.68	.803	3.58	3.63	3.84	3.71	.872
2.7.5	Concealing losses	98	3.33	1.003	3.00	3.19	3.39	3.71	.060
2.7.6	Use of misuse of asset-aside interests	97	3.30	.880	3.04	3.48	3.22	3.39	.395
2.7.7	Accounting changes	96	3.34	.938	3.08	3.36	3.33	3.57	.423
2.7.8	Foreign currency	97	3.20	.953	3.12	2.88	3.22	3.54	.129
2.7.9	Manipulation of the loan loss provision	98	3.33	1.110	2.92	3.37	3.67	3.43	.170

Note: This table shows the mean and standard deviation (SD) for all respondents regarding questions about earnings management tools. It also provides the mean for each group and the p-value for the Kruskal-Wallis (K-W) test. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. Bold figure indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

Although a number of techniques were mentioned during the interviews, LLP was the technique most mentioned, according to interview findings reported in Chapter 6 (Table 6.8); 64% of interviewees thought that LCBs' managers use LLP to alter their reported income. LLP is suggested by the accounting literature investigated in Chapter 3 to be amongst the most likely tools for earnings management by a bank. Moreover, it may be the most widely used technique since it represents a large accrual figure that bank managers can use for earnings management (Sun and Rath, 2010). The results reported in Table 7.9 are consistent with the literature in respect of the usage of LLP as an earnings management tool.

The second highest mean score (3.68) was given to Investments (Q 2.7.4). The term "Investments" refers to either long term or short term amounts invested in shares. The valuation of these shares may increase or decrease at the year-end which requires an accounting treatment that would affect the reported income on a Fair Value basis. Based on this result, and given that it received the second highest mean score, one might argue that LCBs depend, to a large extent, on 'investment' to manage their earnings which is inconsistent with both the literature and prior interview findings.

Although the KW results did not reveal any significant differences in Table 7.9 (Panel A), to be consistent with the analysis order adopted in this chapter, Mann-Whitney tests were performed for more details and discussion. The results of the six MW tests are displayed in Table 7.9 (Panel B).

Table 7.9: Earnings Management Techniques
Panel B: M-W test

Q	Statement	K-W P-values	M-W p-values					
			PR-AD	PR-RG	PR-US	AD-RG	AD-US	RG-US
2.7.1	Reserves	.918	.958	.916	.595	.885	.606	.599
2.7.2	Revenue recognition	.942	.886	.976	.663	.848	.577	.811
2.7.3	Disposing of high market value assets	.536	.412	.636	.742	.164	.272	.844
2.7.4	Investments	.872	.928	.566	.773	.398	.668	.731
2.7.5	Concealing losses[104]	.060	.539	.195	**.013***	.491	.055	.207
2.7.6	Use of misuse of asset-aside interests	.395	.101	.506	.265	.329	.618	.737
2.7.7	Accounting changes	.423	.509	.531	.113	.904	.307	.381
2.7.8	Foreign currency	.129	.375	.959	.257	.290	**.014***	.213
2.7.9	Manipulation of the loan loss provision	.170	.212	**.026***	.164	.208	.800	.429

Note: This table shows the p-values produced by M-W test between the different groups regarding questions about earnings management tools. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. Bold figure indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

The test results shown above in Panel B reveal three significant differences among the stakeholders.

The first significant difference is between the Preparer and Regulator groups as regard to the use of LLP as a means of managing LCBs' earnings. The Preparers' mean score was only 2.92 (the least) which suggests that these stakeholders do not regard this method as a potential way for managing earnings in the LCBs. On the other hand, the Regulators group showed a mean score of 3.67 (the highest) revealing their relatively strong agreement with the view that LLP may be used for earnings management by LCBs. In addition, the questionnaire responses by the Regulators group (Appendix 7.5) reveal more details that may clarify this difference in perceptions. The responses of Regulators to this statement were, to a large extent, clearly in favour of the potential use of the LLP, as 15 Regulators expressed agreement with the statement whereas only 2 expressed their disagreement, one of which was strong disagreement. The responses of the Regulators should be viewed in

[104] Although Concealing Losses is not a specific technique, it could be achieved, as interview findings showed, by several ways, for example, postponing the booking of some expenses to the next period so that current period income is boosted. This technique may be used when the bank is not invoiced yet or the supplier has not requested payment. Omitting financial transactions, such as this case, is fraud rather than earnings management (according to the UK definition of earnings management). One of the potential interesting findings this study may reveal is that LCBs are committing fraud when they think of themselves practicing earnings management.

the light of the fact that most of them have work experience at the Central Bank of Libya and three of them work for the tax authority. Both these experiences may indicate a good deal of knowledge regarding the environment in which LCBs work and the way LCBs' financial information is compiled and presented.

On the other hand, Preparers' responses were not that clear. As discussed above, 11 Preparers agreed that LLP could be used to manage earnings, one of which was strongly agree, while 9 Preparers disagreed with the statement including 5 who strongly disagreed about the potential use of LLP for earnings management by LCBs.

The second significant difference appeared between the Preparer and User groups regarding the use of loss concealment (Q 2.7.5) by LCBs to affect reported income. This difference may have occurred because of that the Users group has had the highest mean score of 3.71 while the Preparers' gave more neutral responses yielding an exact mean score of 3.00. This apparent different can also be explained by looking at the questionnaire responses of individual groups. For example, the questionnaire responses from Preparers (reported in Appendix 7.3) shows that 10 Preparers agreed that concealing loss is potentially used to manage LCBs' earnings. On the other side, 8 Preparers disagreed with this view; 2 of them expressed their strong disagreement. 5 Users disagreed and 19 agreed including 6 who strongly agreed.

The last significant difference is that between the Auditors and Users groups regarding the usage of exchange rates manage LCBs' reported income. This was the subject of aggregate disagreement by the Auditors group according to their mean score of 2.88 (the least) compared to Users' mean score of 3.54 (the highest). This potential conflict in views can be explained as follows: most Auditors are not professionally qualified and thereby may arguably be viewed as lacking the required scepticism and/or it may simply be that some of the respondent Auditors do not possess a high level of experience, given the fact that 15

(55.6%) of Auditors have less than 5-years of banking experience (see Table 7.2). On the other hand, the Users group consisted mainly of academics that may, arguably, be viewed as having less practical experience but look at such issues normatively. However, all other stakeholder groups showed, on balance, agreement that 'foreign currency' may be used by LCBs' managers to alter reported earnings.

7.5.2.7 Perceptions about Factors that may Enable Earnings Management Practices

This section investigates the factors that might give bank managers the opportunity to manage earnings. In other words, if bank managers decide to report lower or higher income, what factors may make this behaviour feasible and possibly quite easy. Stakeholders groups were asked to express their agreement or disagreement regarding a set of nine factors. In order to identify any differences in views regarding these factors a KW test was performed. The test results are displayed in Table 7.10 (Panel A).

Table 7.10: Potential Factors that may Enable Bank Managers to Practice Earnings Management
Panel A: K-W test

Q	Statement	N	Mean	SD	Group Means				K-W P-value
					PR	AD	RG	US	
2.8.1	Local accounting practices	96	3.56	.904	3.71	3.48	3.84	3.32	.310
2.8.2	Ineffective external audit function	99	3.83	.904	3.64	3.78	4.05	3.89	.510
2.8.3	Poor corporate governance mechanism	99	3.91	.809	3.84	3.89	4.05	3.89	.888
2.8.4	Poor commercial and business knowledge of users	97	3.86	.829	3.64	4.00	3.89	3.89	.471
2.8.5	Ineffective monitoring by CBL	98	3.84	.870	3.68	3.93	3.83	3.89	.751
2.8.6	Ineffective monitoring by LSM	99	3.80	.869	3.76	3.74	3.79	3.89	.789
2.8.7	Ineffective monitoring by Tax authority	98	3.76	.897	3.67	3.81	3.89	3.68	.820
2.8.8	Difficulty of detection by auditors	98	3.54	1.007	3.37	3.56	3.68	3.57	.761
2.8.9	Difficulty of detection by users	99	3.67	.904	3.36	3.78	3.74	3.79	.380

Note: This table shows the mean and standard deviation (SD) for all respondents regarding questions about the factors may open the door for bank managers to be engaged in earnings management practices. It also provides the mean for each group and the p-value for the Kruskal-Wallis (K-W) test. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. Bold figure indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

All stakeholders groups were, on average, in agreement that the above factors could have enabled bank managers to be engaged in earnings management practices. Focusing on the average of responses, the results indicate that all factors were considered by respondents to have the potential to influence earnings management practices given the recorded mean values significantly over the mid-point. It is worth mentioning that the term “local accounting practices” does not refer to Libyan accounting standards; rather it refers to the current accounting practices that are accepted by local practitioners. As reported in Chapter 6, a majority of the interviewees (93%) believe that the lack of local accounting standards play a crucial role in the existence of earnings management. One of the interviewees (AD3) who stressed the importance of having accounting standards wherever they originate from confirms that the absence of accounting standards leads to earnings management. He stated:

> "The absence of standards opens the door for manipulation. We need standards as a background for using as one language. Any standards would help even from anywhere".

The lack of good corporate governance has been ranked as the factor that most assists in opening the door for bank managers to engage in earnings management practices; it was associated with highest mean score of 3.91. On the other hand, the difficulty in detecting earnings management practices by external auditors was given the lowest mean score of 3.54.

To investigate whether there were significant differences in the views expressed, six MW tests were conducted and the results are summarized in Table 7.10 (Panel B).

Table 7.10: Potential Factors that may Enable Bank Managers to Practice Earnings Management
Panel B: M-W test

Q	Statement	K-W P-values	M-W p-values					
			PR-AD	PR-RG	PR-US	AD-RG	AD-US	RG-US
2.8.1	Local accounting practices	.310	.369	.569	.243	.130	.643	.126
2.8.2	Ineffective external audit function	.510	.719	.228	.296	.306	.390	.956
2.8.3	Poor corporate governance mechanism	.888	.821	.557	.838	.370	.738	.774
2.8.4	Poor commercial and business knowledge of users	.471	.119	.310	.254	.585	.739	.552
2.8.5	Ineffective monitoring by CBL	.751	.300	.563	.351	.879	.925	.841
2.8.6	Ineffective monitoring by LSM	.789	.933	.841	.407	.766	.329	.667
2.8.7	Ineffective monitoring by Tax authority	.820	.589	.394	.913	.567	.745	.526
2.8.8	Difficulty of detection by auditors	.761	.721	.349	.383	.531	.671	.917
2.8.9	Difficulty of detection by users	.380	.136	.227	.137	.972	.806	.786

Note: This table shows the p-values produced by M-W test between the different groups regarding questions about the factors may open the door for bank managers to be engaged in earnings management practices. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. Bold figure indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= “Strongly disagree” to 5= “Strongly agree”.

The MW tests results revealed no significant difference among the stakeholders groups. This was expected from an analysis of the mean scores of each group which showed a relatively strong level of agreement as the mean scores were well above the mid-point for each group. In other words, stakeholder groups acknowledge explicit weaknesses in the accountability process within the Libyan Commercial Banks. Such factors if addressed would arguably deter bank managers from engaging in earnings management, which then should lead to better quality financial reporting and thus an improvement in accountability. These results are not unexpected and are consistent with the interview findings reported in Chapter 6.

For example, stakeholder groups agreed that the local accounting practices can play a role in allowing earnings management practices among LCBs which may suggest a need to adopt International Accounting Standards (IAS/IFRS). In other words, accounting standards may have an important role in the accountability system. Views on how earnings management would thus be deterred and financial reporting would be improved, and ultimately, accountability enhanced, are examined in the next question (Q 2.9).

7.5.2.8 Perceptions about Earnings Management Constraints

Having discussed the factors which may enable bank managers to engage in earnings management, this section aimed to identify certain elements that may constrain bank managers from practicing earnings management. Respondents were asked to indicate their agreement or disagreement regarding certain procedures that if adopted might deter earnings management practices by LCBs. The responses to this question (Q 2.9) are summarized in Table 7.11 (Panel A).

Table 7.11: Earnings Management Constraints
Panel A: K-W test

Q	Statement	N	Mean	SD	Group Means				K-W
					PR	AD	RG	US	P-value
2.9.1	Adopting IFRS in practice	99	4.27	.586	4.36	4.00	4.37	4.39	**.046***
2.9.2	Applying good corporate governance	99	4.28	.607	4.24	4.07	4.37	4.46	.079
2.9.3	Educating and training of preparers	98	4.30	.735	4.28	4.04	4.42	4.46	.121
2.9.4	Educating and training of auditors	99	4.25	.733	3.92	4.22	4.26	4.57	**.025***
2.9.5	Educating and training of investors	99	3.88	.884	3.64	3.74	3.79	4.29	**.025***
2.9.6	Strengthen audit regulation	100	4.41	.552	4.31	4.30	4.32	4.68	**.015***
2.9.7	Strengthen oversight of financial reporting	100	4.36	.560	4.27	4.22	4.42	4.54	.100

Note: This table shows the mean and standard deviation (SD) for all respondents regarding questions about the earnings management constraints in the LCBs. It also provides the mean for each group and the p-value for the Kruskal-Wallis (K-W) test. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. Bold figure indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= “Strongly disagree” to 5= “Strongly agree”.

Focusing on the average of the responses by different stakeholders groups, the results indicate a relatively strong agreement by all stakeholder groups regarding the potential value of all listed constraints since, with the exception of the fifth constraint “educating and training of investors” which had a mean score of 3.88, all constraints reported a mean score over 4.00. Table 7.11 (Panel A) shows that what was perceived to be the most important constraint that may have an important impact on earnings management practices was the strengthening of audit regulation.

As with the interview findings reported in Chapter 6 (Table 6.12) where 75% of interviewees believed that IFRS could play a crucial role in deterring earnings management practices and ultimately lead to an improvement in the quality of financial reporting which implies an enhanced accountability. One of the interviewees (RG9) indicated that the application of IFRS would lead to a high quality financial reporting by saying:

> "If IFRS was applied the quality of financial reporting would be 100%..."

The results reported in above in Table 7.11 Panel A agree with the interview findings as regards to IFRS. It is notable that questionnaire respondents are not satisfied with the audit profession itself as their mean score of 4.41 (the highest in Table 7.11, Panel A) is very high. Revisiting the interview findings reported in Chapter 6, the audit profession in Libya faces certain challenges; according to AD3, the audit profession in Libya suffer from auditors themselves. He indicated:

> "… The profession is suffering. In Libya there is a problem unfortunately; industry got a lot of unqualified auditors meanwhile a lot of qualified people as well…".

The questionnaire findings in this regards come in line with those reported by interviewees as mentioned above. The statements (Q 2.9.4 and 2.9.6) reflect the questionnaire respondents' agreement, on balance, that audit profession in Libya have a lot work to do, for example, to train auditors and place some regulation as to strengthen the profession. Given the important role of the external auditor in the accountability process, these results may reveal serious shortcoming to the current accountability system of LCBs as it is acknowledged by respondents that audit profession weak and auditors need to be trained.

Table 7.11 (Panel A) reveals a number of significant differences between stakeholder groups regarding the influence of certain constraints in deterring bank managers from being involved in earnings management practices. The overall results of the differences between stakeholders groups indicate that, although they agreed on the effect of the above-mentioned constraints, there were some significant differences among them about the degree of the impact of these constraints. To identify which pairs may have different views in respect to these constraints, six Mann-Whitney tests were conducted and the results are summarized in Table 7.11 (Panel B).

Table 7.11: Earnings Management Constraints
Panel B: M-W test

Q	Statement	K-W P-values	M-W p-values					
			PR-AD	PR-RG	PR-US	AD-RG	AD-US	RG-US
2.9.1	Adopting IFRS in practice	**.046***	**.024***	.867	.687	**.035***	**.018***	.899
2.9.2	Applying good corporate governance	.079	.364	.550	.116	.122	**.024***	.421
2.9.3	Educating and training of preparers	.121	.212	.799	.330	.099	**.025***	.491
2.9.4	Educating and training of auditors	**.025***	.368	.252	**.006***	.641	**.020***	.142
2.9.5	Educating and training of investors	**.025***	.744	.665	**.015***	.910	**.008***	**.034***
2.9.6	Strengthen audit regulation	**.015***	1.000	1.000	**.006***	1.000	**.018***	**.014***
2.9.7	Strengthen oversight of financial reporting	.100	.952	.347	.053	.299	**.048***	.361

Note: This table shows the p-values produced by M-W test between the different groups regarding questions about the earnings management constraints in the LCBs. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. Bold figure indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= “Strongly disagree” to 5= “Strongly agree”.

The above table (Panel B) reveals several significant differences between stakeholders groups. Most of these differences were between the Auditors and the other groups. For the first point, adopting the IFRS in practice, the Auditors group has a significantly different view point from all the other stakeholder groups. Also, the Preparers and Users groups have three significant differences regarding educating and training of auditors, educating and training of investors, and strengthening audit regulation. Regulators and Users groups significantly viewed the educating and training of investors, and strengthening audit regulation in different ways.

7.5.2.9 Perceptions about Earnings Management Ethics

This question (Q 2.10) sought to explore the respondents’ agreement or disagreement regarding the acceptability of earnings management practices. Respondents were asked how they perceived the nature of ethical practice at first. Then they were asked how they viewed the exercise of earnings management when applied within the law and GAAP limits before being asked to indicate whether earnings management is an unethical practice. The responses as well as the KW p values are presented in Table 7.12 (Panel A).

Table 7.12: Stakeholders' Perceptions about the Ethics of Earnings Management
Panel A: K-W test

Q	Statement	N	Mean	SD	Group Means				K-W P-value
					PR	AD	RG	US	
2.10.1	Ethical behaviour mean complying with law	97	3.71	.912	3.71	3.77	3.84	3.57	.946
2.10.2	Ethical behaviour mean thinking about the impact of one's decisions on others	96	3.80	.776	3.63	3.96	3.58	3.96	.157
2.10.3	Earnings management is ethical if practiced within the law	96	3.30	1.007	3.22	3.23	3.32	3.43	.880
2.10.4	Earnings management is ethical if practiced within the GAAP	98	3.30	1.017	3.28	3.35	3.21	3.32	.950
2.10.5	Earnings management affects others' interests	97	3.80	.745	3.78	3.81	3.74	3.86	.958
2.10.6	Earnings management is an unethical practice	95	3.07	.959	3.17	3.00	2.95	3.15	.831

Note: This table shows the mean and standard deviation (SD) for all respondents regarding questions about earnings management ethicalness. It also provides the mean for each group and the p-value for the Kruskal-Wallis (K-W) test. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. Bold figure indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

The overall averages of the mean responses indicate a slight agreement with all questions which was partially unexpected given the sensitivity of the moral questions being covered. In particular, one would expect a higher agreement from some stakeholders e.g. the Users group, about whether earnings management aas an unethical practice. The responses indicate that ethical behaviour implies consistency with the law and consideration of the effect of decisions on others, with means of 3.71 and 3.80 respectively. This was followed by the agreement of stakeholder groups that earnings management would be ethical if practiced within the law and GAAP (the average mean scores were 3.30 for both questions). Also, earnings management was, on average, agreed by stakeholders to have an impact on other people's interests by being given a mean score of 3.80. And finally, whether earnings management is perceived as ethical or not, the overall mean score of 3.07 reveals that all stakeholders groups consider that, on balance, and narrowly, earnings management is considered an unethical practice. Although, this result is expected, given the sensitivity of such moral questions, it was only slightly over the mid-point which means a very mild level of agreement with this question. Also this result is inconsistent with earlier findings; stakeholder groups agreed, on balance, that behaving ethically means to comply with law and consider others' interest when making decisions. In particular, they agreed, on average, that earnings management could be regarded as ethical if it was implemented within the law and GAAP. Moreover, stakeholder groups, on balance, acknowledge that earnings management practices have an influence on the interests of others. All the above results are inconsistent with the last one, as it is expected to see a relatively wide agreement that earnings management is perceived as unethical practice. However, this result is, to large extent, consistent with interview findings reported in Chapter 6 (Table 6.11) which refer to 50% of interviewees indicating that earnings management is an ethical practice. The individually responded questionnaires (Appendices 7.3, 7.4, 7.5, and 7.6) refer to responses almost equally spread on both sides of agreement. For example, the notable unexpected result that the Regulators group, on balance, disagreed that earnings management is an unacceptable practice; their responses to this statement were 6 disagreements and 5 agreements. The position of Regulators in terms of LCBs' financial reporting, as scrutiny, may lead to a presumption that earnings management is viewed as unethical practice by LCBs' managers. On the other hand, the (on balance) disagreement by the Preparers group, which may be expected due to their position in the financial reporting process, should also be viewed with their individual responses questionnaire in mind; their responses turned out as only 4 disagreements, one of which showed a strong disagreement and 7 agreements, two of which showed strongly agreements.

As discussed earlier, the ethics of earnings management as perceived by interviewees in Chapter 6 revealed mix findings. Only 50% of interviewees perceived earnings management practices as unethical. Although questionnaire respondents, on balance, showed an agreement that earnings management ethics is a bit questionable, it was only given a mean score of 3.07 that is slightly over the mid-point. This would really refer to a serious problem of the accountability system of LCBs. Since such behaviour is expected to be reviewed as unethical by a large extent of stakeholders as it does seriously affect the quality of financial reporting. Therefore, there is a need to raise the awareness of stakeholders to such issues, and questionnaire respondents apparently agree with the notion that some stakeholders (preparers, auditors, and investors) may lack the knowledge of such issues as revealed in Table 7.11 (Q 2.9.3, 2.9.4, and 2.9.5). one of this study's objectives and aims is to provide some knowledge about this issue.

Table 7.12 (Panel A) reveals no significant differences in perceptions between the stakeholders groups according to the Kruskal Wallis test. The next test was to identify if any significant difference may occur between any two pairs. Six MW tests were performed and the results are shown in Panel B.

Table 7.12: Stakeholders' Perceptions about the Ethics of Earnings Management
Panel B: M-W test

Q	Statement	K-W P-values	M-W p-values					
			PR-AD	PR-RG	PR-US	AD-RG	AD-US	RG-US
2.10.1	Ethical behaviour mean complying with law	.946	.778	.671	.859	.874	.712	.639
2.10.2	Ethical behaviour mean thinking about the impact of one's decisions on others	.157	.118	.955	.142	.092	.825	.111
2.10.3	Earnings management is ethical if practiced within the law	.880	.813	.662	.447	.812	.597	.821
2.10.4	Earnings management is ethical if practiced within the GAAP	.950	.683	.971	.816	.577	.962	.684
2.10.5	Earnings management affects others' interests	.958	.912	.906	.710	.800	.798	.620
2.10.6	Earnings management is an unethical practice	.831	.475	.409	.839	.919	.685	.603

Note: This table shows the p-values produced by M-W test between the different groups regarding questions about earnings management ethicalness. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. Bold figure indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

The results shown in Table 7.12 (Panel B) reveal no significant differences between any two pairs.

The next section of the questionnaire focused on the role of the external auditor of the Libyan Commercial Banks in respect of earnings management issues.

7.5.3 Earnings Management and the External Auditor

The external auditor plays an important role in corporate financial reporting and represents a key element in the accountability process. As discussed earlier in Chapter 2, the Central Bank of Libya possesses a list of external auditors who are allowed to audit banks due to their qualifications and experience. This section aimed to explore the stakeholders' perceptions regarding some issues related to the external auditors' role.

7.5.3.1 Perceptions about the Effectiveness of the External Auditor

As mentioned earlier, only specifically listed auditors are permitted to conduct an audit of banks. This requirement would imply that listed auditors are of high qualifications and experience, and thereby are effective and able to prevent or at least deter bank managers from being involved in earnings management practices. Stakeholders were asked to assess the capability of listed auditors for auditing banks and how able they are to deter and prevent earnings management. The use of the auditor's report in helping interested parties assess the bank's financial performance was also examined. In addition, a question addressed views as to whether the auditor's reporting is being used by the auditor to deter or prevent the practice of earnings management. The results are summarized in Table 7.13 (Panel A).

Table 7.13: Stakeholders' Perceptions about External Auditors Efficiency
Panel A: K-W test

Q	Statement	N	Mean	SD	Group Means				K-W P-value
					PR	AD	RG	US	
3.1.1	Listed auditors, in practice, are well qualified and capable to audit banks	102	3.18	1.066	3.30	3.11	3.20	3.11	.860
3.1.2	The auditor's report is relied upon when assessing a bank's financial performance	102	3.69	.844	3.85	3.37	3.65	3.86	.074
3.1.3	Listed auditors are likely to detect and deter earnings management practices in LCBs	102	3.37	.943	3.52	3.26	3.55	3.21	.523
3.1.4	An auditor's ability to report on earnings management is compromised by audit fees	102	2.98	.975	2.96	2.70	3.00	3.25	.253
3.1.5	An auditor's willingness to report earnings management breaches is compromised by conflict of interest to an auditor's independence	102	3.09	.902	2.96	3.07	3.00	3.29	.519
3.1.6	The external auditor can prevent the practice of earnings management using the power of the auditor's report	99	3.53	.849	3.81	3.12	3.58	3.61	**.025***

Note: This table shows the mean and standard deviation (SD) for all respondents regarding questions about the external auditor's efficiency. It also provides the mean for each group and the p-value for the Kruskal-Wallis (K-W) test. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. Bold figure indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

As shown in Table 7.13 (Panel A), the mean scores indicate that stakeholders groups agreed to most of the questions. Listed auditors, according to stakeholders groups, were viewed as qualified and capable of performing banks' audits with an average mean of 3.18. It is worth noting that some of the interview findings suggested that at least not all of the listed auditors are perceived as well qualified and able to audit banks due to experience discrepancies among listed auditors as per, for example, PR5:

> "It depends on what is the experience of the auditor in terms of time; an auditor for one year could not, but an auditor who has being auditing for five year for instance could detect and can give some advice on how to reduce the practice".

It is worth looking again at the individual questionnaire responses by Auditors in respect of this statement; it is noted that the numbers of Auditors who agreed and disagreed regarding the capability of listed auditors for bank audits were equally spread: 9 Auditors showed disagreement with only one strongly disagreeing, 9 Auditors showed a neutral attitude, and

9 Auditors showed agreement including 4 with strong agreement. This information may be seen as an inside information since it flows from Auditors who know most about their status.

The stakeholder groups agreed, on balance, also that the auditor's report is being used to help assess the financial performance of banks which again is unexpected and is in conflict with some of the interview findings that suggest auditors' reports are only a legal requirement and nearly ignored in the decision making process.

In keeping with the first finding in this table, stakeholders agreed on balance that listed auditors are able to detect and deter earnings management practices by LCBs which may indicate that this ability is not compromised by any factor i.e. audit fees. However, stakeholder groups disagreed, on balance, that audit fees affect the auditor's ability to report on earnings management, the overall mean score is 2.92. This result comes in conflict with some views expressed in the interviews; for example, one of the interview findings offered by PR4 suggests that bank audit fees may affect the external auditor's ability to report about earnings management practices by LCBs, he indicated:

> "The auditor is supposed to be qualified to detect it through the process of audit. It depends on his personality; if he is not caring about the money he would say no [to earnings management practices]. But actually most of them say ok. Our fees have reached 50,000 LD".

The relative disagreement of audit fees' impact on auditor's ability to report on earnings management could be partially due to the fact that the Auditors group tends, more than others, to disagree with this statement by giving the least mean score of 2.70. Given the responses reported in Appendix 7.4 (Questionnaire responses by only Auditors) it obviously clear the general attitude of Auditors tends to the disagreement side. The Auditors have showed 4 strong disagrees, the most compared to other groups, and 7 disagreements. However, due to the sensitivity of such a question, this may be influenced by their desire to appear not compromised by audit fees. Preparers' responses have spread equally; 10, on the side of disagreement, including 2 strongly disagreements, and 10 on the side of agreement, including 1 strongly agreement.

Stakeholder groups have shown, on balance, a perception that an auditor's willingness to report about earnings management is affected by conflict of interest and thereby auditor's independence is compromised. In other words, there are some perceptions that reporting about earnings management breaches may lead to termination which would affect the auditor decision, and thus his/her independence is compromised. The last question asked about the external auditors' ability to prevent earnings management practices just by the power of the audit report. In other words, if bank managers did not adjust the reported income to undo the earnings management practices according to the external auditor's notes, a qualified opinion will be given by the auditor. Stakeholder groups agreed, on balance, the effective power of the auditor's report. Needless to say no single client would be happy to receive a qualified report.

The perceptions of questionnaire respondents come in line with those reported in Chapter 6 (Table 6.13) which suggest that 89% of interviewees think of the ability of the external auditor in detecting the practices of earnings management. This conforms partially with the, on balance, agreement of questionnaire respondents' agreement of the ability for the external auditor in detecting and deterring earnings management practices. The mean score for this question was 3.37 (Q 3.1.3). In a more specific question regarding the ability of the external auditor in preventing earnings management practices (Q 3.1.6), respondents, on average, apparently agree that the external auditor is able deter such behaviour moreover, this can be achieved through the power of the external auditor's report. However, the interview findings reported in Chapter 6 (Table 6.13) refer to a contradict view, that is, only that the external auditor able to do is detecting the practice of earnings management as for deterring this practice, 25% of interviewees think that the external auditor is unable to do that. And this, as mentioned earlier, could be due to the fact that bank audit fees are relatively high according one interviewee (PR4). Again there is a disagreement between what interviewees have said and questionnaire respondents have expressed; interview findings suggest bank audit fee as to affect the ability of the external auditor in deterring earnings management, while questionnaire respondents, on average, disagree to the effect of bank audit fees. Instead, questionnaire respondents, on average, agree of the potential effect of that conflict of interest may have on the external auditor's independence thus ability to deter earnings management practices.

The results articulated in Table 7.13 (Panel A) reveal only one significant difference; therefore, six Mann-Whitney tests were implemented to identify which pairs have conflicting views. The results of these tests are presented in Panel B.

Table 7.13: Stakeholders' Perceptions about External Auditors Efficiency
Panel B: M-W test

Q	Statement	K-W P-values	M-W p-values					
			PR-AD	PR-RG	PR-US	AD-RG	AD-US	RG-US
3.1.1	Listed auditors, in practice, are well qualified and capable to audit banks	.860	.481	.714	.533	.564	.905	.798
3.1.2	The auditor's report is relied upon when assessing a bank's financial performance	.074	**.032***	.262	.972	.265	**.037***	.290
3.1.3	Listed auditors are likely to detect and deter earnings management practices in LCBs	.523	.305	.987	.268	.374	.816	.280
3.1.4	An auditor's ability to detect earnings management is compromised by audit fees	.253	.386	1.000	.335	.278	.057	.249
3.1.5	An auditor's willingness to report earnings management breaches is compromised by conflict of interest to an auditor's independence	.519	.554	.836	.213	.553	.488	.209
3.1.6	The external auditor can prevent the practice of earnings management using the power of the auditor's report	**.025***	**.005***	.246	.420	.054	**.042***	.783

Note: This table shows the p-values produced by M-W test between the different groups regarding questions about the external auditor's efficiency. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. Bold figure indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

Although one significant difference resulted from the KW test, four significant differences appeared when the MW tests were performed. The first resulted between Preparers and

Auditors groups regarding the use of the external auditor’s report, it can be seen from Table 7.13 (Panel A) that both groups agreed to reliance being placed on the auditor’s report in the financial decision making process. Also, Preparers and Users groups seemingly have a conflict of views in this respect as the MW test results in a significant difference between them (.037). The Preparers and Auditors again show a significant difference in connection with the influence of the external auditor’s report in preventing earnings management practices, and there was also a significant difference between Preparers and Users regarding the same question. However, all groups’ means reveal an aggregate level of agreement with the last question.

The implications of the results reported above in Table 7.13 (Panel A, Panel B) on the accountability process stem basically from the importance role of the external auditor within accountability mechanism. The function of the external audit rely mainly on the qualification and independence of the external audit. If the external audit was not qualified, in this case to conduct bank audit, and that his/her independence is compromised by i.e audit fees would potentially affect the external audit efficiency and then compromise the accountability of LCBs which is, according to this study, to provide of high quality financial information, more specifically, to provide financial information free from earnings management.

The next section discusses, in addition to the use of the external auditor’s report, whether the external auditor is aware of his/her accountability towards other stakeholders rather than only shareholders.

7.5.3.2 Perceptions about External Auditor Accountability

This section examined the external auditor’s awareness of his/her accountability from the viewpoint of different stakeholders. Respondents were asked to indicate their agreement or disagreement as to whether external auditors are aware of their responsibility towards shareholders and other parties who may make a decision based on the external auditor's report. The section also surveyed perceptions of the use of the external auditor's report by stakeholders. Finally, the section also examined one of the viewpoints of an interviewee that the external auditor's report is only a legal requirement and that it is not used in the financial decision making process. The results are presented in Table 7.14 (Panel A).

Table 7.14: The External Auditor's Accountability and the Extent to Which His/Her Report is used
Panel A: K-W test

Q	Statement	N	Mean	SD	Group Means				K-W P-value
					PR	AD	RG	US	
3.2.1	External auditors are fully aware of their accountability to the shareholders	98	3.46	1.047	3.64	3.64	3.80	3.07	.074
3.2.2	External auditors are fully aware of their accountability to the third parties	97	3.33	.898	3.56	3.56	3.47	3.04	.128
3.2.3	The auditor's report is widely used by interested stakeholders	98	3.46	.864	3.80	3.80	3.65	3.14	**.040***
3.2.4	The auditor's report is only a legal requirement and not used widely in the financial decision making process	98	2.85	1.068	2.52	2.52	2.70	3.00	.223

Note: This table shows the mean and standard deviation (SD) for all respondents regarding questions about the auditor's accountability and his report extent. It also provides the mean for each group and the p-value for the Kruskal-Wallis (K-W) test. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. Bold figure indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

Table 7.14 (Panel A) shows the overall mean responses for these questions. The average responses indicate that, overall stakeholders groups agree that the external auditor is mindful of his/her responsibility and accountability not only to shareholders but beyond; the results also reveal that external auditors are aware of their accountability to third parties. The average means were 3.46 and 3.33 respectively. Stakeholders groups also agreed that the auditor's report is being widely used by interested stakeholders in the decision making process with a mean score of 3.46, and, unexpectedly, refuted the notion that the auditor's report is only a legal requirement and not widely used in financial decision making. This result is at variance with the interview findings reported in Chapter 6 as some interviewees indicated that the external auditor's report is not widely used. RG5, for example, stated that "There is no relying on it [auditor's report] at all. It is only a legal requirement". In this respect, questionnaire respondents were directly asked whether the external auditor's report has no use and is only asked in complying with regulations. The result comes contradict to those reported in Chapter 6 which suggest no use to the external auditor's report, more specifically, questionnaire respondents, on average, disagree with the notion that auditor's report not being relied upon or it is just a legal requirement.

The K-W test points out a significant difference amongst the groups regarding the use of the external auditor's report by interested stakeholders. To identify which pairs have significantly differing viewpoints, 6 M-W tests were performed and the results are shown in Table 7.14 (Panel B).

Table 7.14: The External Auditor's Accountability and the Extent to Which His/Her Report is used
Panel B: M-W test

Q	Statement	K-W P-values	M-W p-values					
			PR-AD	PR-RG	PR-US	AD-RG	AD-US	RG-US
3.2.1	External auditors are fully aware of their accountability to the shareholders	.074	.496	.549	**.040***	.243	.215	**.024***
3.2.2	External auditors are fully aware of their accountability to the third parties	.128	.290	.562	**.027***	.665	.228	.113
3.2.3	The auditor's report is widely used by interested stakeholders	**.040***	**.043***	.627	**.012***	.209	.507	.085
3.2.4	The auditor's report is only a legal requirement and not used widely in the financial decision making process	.223	.052	.550	.172	.191	.734	.437

Note: This table shows the p-values produced by M-W test between the different groups regarding questions about the auditor's accountability and his report extent. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. Bold figure indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

The results shown in Table 7.14 (Panel B) pointed out a number of significant differences. Preparers and Users groups have shown different views regarding the auditors' awareness of their accountability towards shareholders; although both agreed with the statement on balance as their mean scores suggest, though the Users group's agreement is only slightly above the mid-point (3.07). Regulators and Users have also shown a disagreement regarding this question. The second statement has a significant difference between Preparers and Users, who have generated mean scores of 3.56 and 3.04 respectively, it is notable that the Preparers' mean is the highest while the Users is the lowest.

Although Preparer and Auditor groups generated the same mean score of 3.80 regarding the use of the auditor's report by stakeholders, M-W results reveal a significant difference between these two groups towards this statement. The M-W results also show a significant difference for this statement between preparers and users groups whose mean scores are 3.80 and 3.41 respectively.

7.5.3.3 Perceptions about the Use of the External Auditor's Report by Various Stakeholders

The use of the auditor's report has been generally discussed earlier; this section reports, in particular, which stakeholders are perceived to be using the external auditor's report. Respondents were asked to assess the use of the external auditor's report by a certain list of stakeholders. The listed stakeholders have been partially mentioned in the interviews, others are drawn from the literature. However, the results shown in Table 7.15 (Panel A and B) reveal no significant differences and the respondent groups all agreed (on aggregate) and with different levels, that the auditor's report is being used by these stakeholders.

Table 7.15: The External Auditor's Report Use by Various Stakeholders
Panel A: K-W

Q	Statement	N	Mean	SD	Group Means				K-W P-value
					PR	AD	RG	US	
3.3.1	Shareholders	99	3.88	.848	4.04	3.72	3.90	3.86	.487
3.3.2	Management	99	3.70	.963	3.85	3.40	3.95	3.64	.304
3.3.3	Employees	98	3.22	.914	3.36	3.08	3.45	3.07	.475
3.3.4	Tax authority	98	3.76	.909	3.96	3.58	3.80	3.68	.531
3.3.5	Current and potential customers	96	3.49	.962	3.58	3.52	3.47	3.39	.864
3.3.6	The Libyan Stock Market	98	4.02	.786	3.92	3.88	4.10	4.18	.309
3.3.7	Central Bank of Libya	99	4.09	.771	4.15	3.96	4.00	4.21	.376
3.3.8	Corresponding banks	96	3.64	.964	3.58	3.60	3.75	3.63	.989
3.3.9	Media	97	3.27	1.005	3.25	3.28	3.45	3.14	.825
3.3.10	Academia and research centers	98	3.43	.952	3.48	3.44	3.70	3.18	.359
3.3.11	Society as a whole	97	3.24	.966	3.42	3.24	3.40	2.96	.411

Note: This table shows the mean and standard deviation (SD) for all respondents regarding questions about who use the auditor's report. It also provides the mean for each group and the p-value for the Kruskal-Wallis (K-W) test. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. Bold figure indicates significance at the 5% level.
A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

As the results in Table 7.15 (Panel A) suggest, no significant differences appeared from the K-W test. This indicates, unexpectedly, a view that all listed stakeholders, on balance, and on aggregate, are using the external auditor's report. However, The Central Bank of Libya and the Libyan Stock Market have been indicated to be the users for whom there is strongest agreement that they use the external auditor's report with mean scores of 4.09 and 4.02 respectively. On the other hand, Employees have been indicated as the least users of the external auditor's report, however, with a mean score of 3.22.

Table 7.15: The External Auditor's Report Use by Various Stakeholders
Panel B: M-W test

Q	Statement	K-W P-values	M-W p-values					
			PR-AD	PR-RG	PR-US	AD-RG	AD-US	RG-US
3.3.1	Shareholders	.487	.148	.546	.460	.430	.416	1.000
3.3.2	Management	.304	.118	.704	.675	.076	.345	.445
3.3.3	Employees	.475	.336	.860	.305	.250	.895	.217
3.3.4	Tax authority	.531	.103	.438	.551	.479	.563	.893
3.3.5	Current and potential customers	.864	.537	.405	.566	.721	.841	1.000
3.3.6	The Libyan Stock Market	.309	.630	.685	.225	.356	.101	.398
3.3.7	Central Bank of Libya	.376	.328	.570	.413	.815	.137	.259
3.3.8	Corresponding banks	.989	.709	.949	.996	.789	.875	.773
3.3.9	Media	.825	.936	.604	.681	.560	.644	.395
3.3.10	Academia and research centers	.359	.809	.374	.302	.287	.390	.119
3.3.11	Society as a whole	.411	.484	.999	.155	.568	.359	.205

Note: This table shows the p-values produced by M-W test between the different groups regarding questions about who use the auditor's report. Groups are defined as; preparers (PR), auditors (AD), regulators (RG), and users (US) for each question. Bold figure indicates significance at the 5% level.

A 5-point Likert scale was used in these questions. It ranged from 1= "Strongly disagree" to 5= "Strongly agree".

The results in Table 7.15 (Panel B) point out no significant differences between any two groups in respect of the using of the auditor's report by the various stakeholders. These results as well as of those reported in Table 7.15 (Panel A) come in line with those reported above in Table 7.14 (Panel A and B) which indicate, on balance, wide use of the external auditor's report by shareholders and other stakeholders.

7.6 Summary and Discussion

The questionnaire was conducted in order to obtain a larger view of stakeholders about earnings management practices and related issues in the Libyan Commercial Banks context. More specifically, it meant to investigate the difference in views between the various stakeholder groups; preparers, auditors, regulators, and users. Although stakeholder groups responded consistently in many questions, the differences in views amongst stakeholders groups have been mentioned in due course as necessary.

This summary discussion will be restricted only to the main research and subsidiary questions.

The quality of financial reporting by LCBs was perceived, on balance, but by a fairly narrow margin, to be of good quality by all groups except the Users group. As for listed LCBs all stakeholder groups showed on balance narrow agreement that listed LCBs' financial reporting is of good quality. Moreover, listed LCBs' financial statements were viewed, again on balance and by a narrow margin as providing relevant and reliable information. However, it is evident that a disparity of views typically exists within different stakeholder groups in regards to the quality of LCBs' financial reporting. This range of views shows that, in spite of narrow agreements in aggregate, important doubts exist in all the stakeholder groups regarding the accountability of LCBs. This will more discussed in the conclusion in Chapter 8.

The term 'earnings management' is apparently not well understood amongst different stakeholders of LCBs. Although most of them acknowledged that they heard of it, the term has been interpreted in some different ways which may refer to their uncertainty to what it exactly refers to. However, all stakeholder groups agreed the most of the short definition of earnings management, as well as other statements. Subsequent to respondents being asked about their understanding of the term 'earnings management' all respondents were offered a definition for what earnings management is in order to ensure that afterwards questions were answered concisely as regards the interpretation of the rest of the questionnaire. All stakeholder groups agreed, on average, that earnings management affects the quality of financial reporting and that both listed and unlisted private LCBs are engaged in earnings management practices. As for state-owned LCBs, Regulators and Users groups agreed, on balance, regarding the existence of earnings management practices however, Preparers and Auditors, on the other hand, on average, disagreed about the existence of earnings management practices within unlisted state-owned LCBs.

The motivations which are thought to be behind the exercise of earning management in LCBs are the same as those in the literature. Management compensation and job security, regulatory and political, and capital market motivations are perceived, on balance, by all stakeholder groups to have induced LCBs' managers to intervene in the process when it comes to determining the reported income. This can be achieved, according to the questionnaire results by all listed techniques that respondents were asked about. LLP, which the literature suggests is the most influential technique of earnings management by banks, is perceived to be used by LCBs' managers as well as other techniques. The results also suggest that LCBs' managers tend to use both accounting and real earnings management.

Questionnaire respondents provided interesting results in respect of their views about earnings management ethics. Stakeholder groups had very mixed views about whether earnings management is an unethical practice, however they showed a relatively high agreement that earnings management is acceptable when it complies with both law and GAAP. This result comes in conflict with another result, that is, the stakeholders' agreement that some of the techniques used to manage earnings are explicitly out of GAAP and breaching the law e.g. their agreement of using 'concealing losses and foreign exchange'.

Earnings management behaviour is viewed as having a place in LCBs' financial reporting due to the existence of a range of factors. Stakeholder groups agreed, on balance, that such behaviour does exist because of local accounting practices, weak external auditor, and poor corporate governance.

The above discussion leads to the assumption that financial reporting of LCBs implies managed earnings by some techniques with some certain motivations lied behind which eventually suggest that LCBs' financial reporting would have been of less quality[105] given the existence of the motivations and factors that may facilitate such behaviour. It could also be due to the mixed views that earnings management is unethical. All that should draw attention to the accountability relationship of LCBs as the existence of earnings management affect the quality of financial reporting and ultimately leads to providing biased information or in other words, reveal that LCBs' managers are not properly held accountable.

Due to the importance of an accountability system in almost all corporations, in particular those which have a wide range of stakeholders, e.g. banks it is of high crucially to seek various ways to improve the accountability. The questionnaire results shed light on how, it is thought, by an informed body of opinion, accountability could be promoted. Specifically, the role of IFRS, corporate governance, and the external auditor were all supported with a slightly greater level of agreement that the latter would help in this regard.

In respect of the impact of adopting the international accounting standards (IFRS), questionnaire results showed, on average, agreement amongst LCBs' various stakeholders that IFRS would improve the accountability system of LCBs. Adopting IFRS would, it thought, improve the quality of LCBs. This should therefore lead to LCBs' managers being held more accountable to LCBs' stakeholders.

[105] Despite the, on balance, agreement that LCBs' financial statement are of good quality and provide relevant and reliable information.

As well, applying good corporate governance is seen by different LCBs' stakeholders to have an influence over the occurrence of earnings management. The quality of LCBs' financial reporting would therefore be promoted and thus so would accountability. Applying good corporate governance is, on average, agreed by all stakeholders to positively affect accountability process of LCBs.

However, the questionnaire results regarding the role of the external auditor in respect of the accountability relationship of LCBs come in with conflicted outcomes. On one hand, LCBs' stakeholders showed, on balance, agreement about the need to educate auditors, strengthen the audit function, and promote the function of financial reporting oversight which could be seen as an acknowledgment by those stakeholders of the weakness of the role of the external auditor in respect of promoting accountability within LCBs. On the other hand, stakeholders showed, on balance, agreement that listed auditors are qualified and capable to the job of banks audit. Moreover, listed auditors are seen, on balance, to be able to detect and deter earnings management practices and, it was thought that, this would not be affected by high fees that bank audit would normally generate. The power the external auditor can rely on was thought to derive from the power of the importance of the auditor's opinion on a bank's financial position. Stakeholders, on balance, agreed about the ability of the external auditor in preventing earnings management practices on the basis of auditor's opinion power.

The external auditor is perceived, on balance, by all stakeholder groups as being held accountable not only to shareholders but to almost all stakeholders of LCBs. Eventually, the role of the external auditor is perceived, on balance, to be in a good level in terms of accountability of LCBs. Based on the above discussion, bank auditors are viewed as being able to detect and prevent earnings management as they have the power to prevent it, in addition they are aware of their accountability and are perceived as accountable to almost all stakeholders.

Chapter 8

Conclusion and Summary

8.1 Introduction

The purpose of this Chapter is to summarise the previous chapters and to provide a general discussion of the empirical findings in the light of the research questions of the thesis and its theoretical framework. This thesis examines a number of issues relating to the topic of earnings management by Libyan Commercial Banks (LCBs) by investigating the perceptions of various stakeholders regarding this topic. Specifically, the perceptions of various stakeholders are studied regarding the quality of financial reporting of LCBs by eliciting their perceptions in respect of earnings management practices of LCBs. How financial reporting of LCBs can be improved is also addressed by investigating stakeholders' perceptions regarding a certain set of ways, by which financial reporting is seen to be improved.

8.2 Summary of the Research

The thesis consists of eight chapters. Chapter 1 introduced and outlined the research topic, motivation, questions and structure. Chapter 2 tries to put the research into the Libyan context by examining the internal environmental factors that are believed to have influenced the accounting practices in Libya. In particular, it provides a background about Libya and briefly examines the environmental factors that may have had an impact on the accounting practices in Libya; the economic system, the political system, the legal system, the education system and the religion of the country are discussed as well as the accounting profession in Libya. Chapter 3 presents the literature review on the earnings management topic, its definitions, motivations, and ethics. Also literature on earnings management practices within the banking sector was addressed. The Chapter also discussed briefly methods to measure earnings management. Chapter 4 outlines the theoretical framework of this study: accountability. This thesis acknowledges the importance of the accountability relationship of LCBs with a wide range of stakeholders who will be affected by their activities therefore, the result of this study are interpreted from an accountability perspective, in particular, with reference to the key aspects of accountability factors identified in Table 4.1. As mentioned in Chapter 4 the accountability as a term is widely seen as a synonym for many terms such as good corporate governance, transparency, efficiency, responsibility, and integrity. Therefore, any shortfall within the accountability relationship may refer to an impairment of the above aspects.

Chapter 5 reviews the study's methodology and methods employed to collect its data. The paradigm of this study is 'interpretive' in which the researcher is looking at the object through people's perspectives. Chapter 6 and 7 report the findings of the two data collection methods used by this thesis: semi-structured interviews and a questionnaire survey, respectively.

8.2 Research Findings

As noted in Chapter 1, the following research questions are examined in this thesis:

1- To what extent is earnings management perceived to influence the quality of financial reporting in LCBs?

- ❖ *What do LCBs' stakeholders understand by the term 'earnings management'?*
- ❖ *How are LCBs' perceived as being able to manage their earnings?*
- ❖ *What are the perceived motivations behind the earnings management practices in LCBs?*
- ❖ *How do LCBs' stakeholders perceive earnings management in terms of business ethics?*
- ❖ *What factors were perceived as enabling LCBs to manage earnings?*

2- To what extent, from an accountability perspective, could such perceptions be addressed?

- ❖ *What do LCBs' stakeholders perceives the implications of adopting IFRS in relation to earnings management?*
- ❖ *How do LCBs' stakeholders perceive the role of the external auditor in relation to earnings management?*
- ❖ *How do LCBs' stakeholders perceive the implications of good corporate governance in relation to earnings management?*

This section reviews the major findings of the study in the light of the research questions. It will briefly review the interview findings and questionnaire results with the focus on differences in views between stakeholder groups that summarised in Table 8.1. Also, it attempts to interpret the research findings on the basis of the accountability framework. In particular research findings will be addresses on the basis of the accountability characteristics that are identified in Table 4.1. The adoption of accountability as a theoretical framework for this study is proposed both as an underlying motive and to identify and understand the issue of LCBs' financial reporting quality and to suggest how it can be improved. In the next section, the stakeholders' perceptions in regard to the research questions are summarised.

Table 8.1: Summary of the Statistically Significant Differences between the Stakeholder Groups from the Questionnaire Findings

Section	Topic	No*	PR-AD	PR-RG	PR-US	AD-RG	AD-US	RG-US
Financial reporting quality and earnings management	Perceptions regarding financial reporting quality	6	0	2	3	0	2	0
	Perceptions regarding earnings management definition	4	0	0	0	0	2	0
	Perceptions regarding the effect of earnings management on financial reporting quality	10	0	1	2	0	0	0
	Perceptions regarding LCBs' accountess	11	0	0	1	0	0	0
	Perceptions regarding earnings management motivations	22	1	0	1	0	0	2
	Perceptions regarding earnings management techniques	9	0	1	1	0	1	0
	Perceptions regarding earnings management determinants	9	0	0	0	0	0	0
	Perceptions regarding earnings management constraints	7	1	0	3	1	7	2
	Perceptions regarding earnings management ethics	6	0	0	0	0	0	0
	Total	**84**	**2**	**4**	**11**	**1**	**12**	**4**
The role of the external auditor in relation to earnings management	Perceptions regarding the auditor's efficiency	6	2	0	0	0	2	0
	Perceptions regarding auditor's report	4	1	0	3	0	0	1
	Perceptions regarding who use auditor's report	11	0	0	0	0	0	0
	Total	**21**	**3**	**0**	**3**	**0**	**2**	**1**
Sub Total		**105**	**5**	**4**	**14**	**1**	**14**	**5**
Rank			**3**	**4**	**1**	**5**	**2**	**3**

Note: This table summarises the significant differences between stakeholder groups at p-value .05. PR = Preparers, AD= Auditors, RG= Regulators, and US= Users. * No. of statements.

8.2.1 Perceptions of Stakeholders on LCBs' Financial Reporting Quality

This section discusses the evidence collected from the empirical work to support answering the first research question: "To what extent is earnings management perceived to influence the quality of financial reporting in Libyan Commercial Banks?" To answer this question a set of five subsidiaries questions were posed and initially stakeholders were asked to assess the quality of financial reporting of LCBs.

At the interviews, stakeholders stressed the crucial importance of financial reporting functions as being in most of the cases the only source of information about LCBs. They also expressed their opinions on the quality of financial reporting by LCBs. The views of stakeholders regarding the quality of financial reporting were mixed. Only 57% of stakeholders perceived the LCBs' financial reporting as being not good. Although this percentage might be seen as showing at least majority agreement many of those who agreed about the good quality of financial reporting were from Preparers (12 out of 28)[106] who may not be expected to criticize the quality of something of their own production (although some did). Interview findings, in this regard, provide mixed views about how different stakeholders perceive the quality and therefore, the accountability process of LCBs.

Questionnaire findings, similarly, showed a range of differences in views between stakeholder groups, as reported in Table 8.1, regarding the quality of LCBs' financial reporting. The range of differences is also evident by looking at questionnaire responses by individual groups. The financial reporting quality of LCBs is perceived differently by stakeholders. This means that accountability is also perceived differently by different stakeholder groups. This conflict of views may refer to a serious breach to the accountability relationship between LCBs' managers and their stakeholders thus indicating lack of trust between both parties.

[106] Please refer to Table 6.3 where it is shows 75% of Preparers agreeing that financial reporting is good.

As stated earlier, to have this question well answered the following subsidiary questions have to be considered.

8.2.1.1 Earnings Management Awareness

In this section, stakeholders' awareness of the term 'earnings management' was examined. The reasonable understanding, by stakeholders, of such a term that is closely related to the quality of financial reporting is basically necessary to understand their comments on the quality of financial reporting.

The interview findings denote a lack of knowledge about the 'earnings management' term as most of them (22 out of 28), representing 79%, answered that they have not heard of such a terminology. However, most of the questionnaire respondents acknowledged their understanding of the issues when they were offered different interpretations to choose from, most of which were derived from interview findings. All stakeholder groups showed, on balance, agreement to all interpretations which may potentially refer to lack of familiarity with such a term or at least uncertainty about the generally accepted meaning of it. One of the key findings of the research is that the literal Arabic translation of the English term "earnings management" may not provide the same meaning as the English term although the literal translation is in use in some Arab countries. This may lead to a high possibility that the translation could cause misunderstanding or be misleading. Reference was made earlier in Chapter 6 that the Arabic translation that was used in this study although it is a literal translation it has been used in other Arabic studies. It is recommended that monitoring, supervisory, and regulatory bodies should take responsibility for spreading an awareness of earnings management and improving society's knowledge of its importance by setting up conferences, seminars and workshops and distributing publications that focus on financial reporting quality and earnings management issues and practices.

As regards the existence of earnings management practices within LCBs, interview findings revealed the view that such a practice does take place. On the other hand, questionnaire results refer to the existence of the practice in LCBs' financial statements with some differences in views depending on ownership structure and listing status. All stakeholder groups showed an average agreement that earnings management is practiced by private LCBs either listed or unlisted. Public listed and unlisted LCBs are also perceived to be engaged in earnings management by all stakeholder groups except by Preparers and Auditors who did not, on balance, agree to the practice of earnings management by unlisted public LCBs.

8.2.2.2 Earnings Management Techniques

Having examined the existence of earnings management by interview findings and questionnaire respondents, this study is also concerned with how LCBs' managers could alter the reported earnings. As reported in the literature and discussed in Chapter 3, LLP is quite commonly used by bank managers as a tool for earnings management. And apparently this is the case in Libya according to a number interviewees. However other ways to manage earnings were raised during the interviews and some of them have been agreed upon by questionnaire respondents. Interview findings reveal that 64% of interviewed stakeholders hold the view that LLP is one of the tools by which LCBs' earnings can be managed. This finding was also corroborated by questionnaire results.

Whatever the technique to manage earnings is to be, the main issue is the existence of earnings management. This raise concerns about the quality of financial reporting. The interview findings and questionnaire results provide evidence on the existence of earnings management in LCBs' financial reporting which may refer to low quality and breach of accountability. For example, some interviewees, provided evidences regarding some techniques that are being used, based on their own experience, to manager LCBs' earnings. AD3, for instance, indicated that 'provisions' including LLP may be the main factor in any bank's financial statements that is available to managers to alter their reported earnings. Another evidence is obtained from PR7 who indicated that bank managers use LLP to alter their earnings. Such statements provide a good piece of evidence that LCBs are engaged in earnings management practices given that fact that some interviewees possess a reasonable knowledge about LCBs' financial reporting[107]. On the other hand, questionnaire results, on average, refer to LLP as being perceived by stakeholders to be used as an earnings management technique.

The financial reporting that is being provided to LCBs' stakeholders, based on the results of this study, may not be fair i.e. the objectivity of the accounting information is not properly applied.

Another major finding this study may refer to is that both interview findings and questionnaire results provide evidence of LCBs' managers actually committing fraud when they thought of themselves as managing earnings. PR10, for example, referred to ignoring booking some expenses in bank's books as being a "legal way" to manage its earnings. this evidence may be seen as an explicit evidence that accounting information provided by LCBs' managers may not be objective and therefore, the entire accounting system of LCBs may lack its main function, according to Ijiri (1983), of being, and of being seen to be, fair.

8.2.2.3 Earnings Management Motivations

The current study examined also the motivations that induce LCBs' managers to be engaged in earnings management behaviour. Interviewees have mentioned certain motivations however 50% of them had the view that 'job security' could mainly be blamed for such a practice by LCBs' managers. However, interview findings provide evidence about other motivations; for example, US1 indicated that earnings management may be practiced to cover corruption as well as for job security reasons.

[107] PR7, for example, as reported in Chapter 6, has been the chief accountant at a commercial bank for 11 years.

Questionnaire results demonstrated views that LCBs' managers could be motivated by a set of motivations: management compensation and job security, regulatory and political reasons, and capital market. This result comes in line with those informed by the literature (see reported earnings management motivations in Chapter 3).

The evidence provided by both interview findings and questionnaire results regarding the motivations of earnings management refer to a serious problem to the accountability. The existence of these motivations, although, they may be unavoidable, put pressure on the accountability process and expose it to a lack of trust and disrepute which therefore may have an adverse effect on the relationship between LCBs' managers and their stakeholders. LCBs' manager should be free from such motivations in order to produce unbiased and fair accounting information.

8.2.2.4 Earnings Management Ethics

The ethics of earnings management was also examined. The total of interviewed stakeholders was equally divided on this matter, as 50% of interviewees think that earnings management is an ethical practice. However, it is worth noting that this includes 67% of interviewed Preparers who believe that earnings management is ethical, which might not be a surprise. However, 75% of interviewed Auditors also think of earnings management as being ethical, which this time, might be surprising. Due to the crucial role that the audit function plays in financial reporting quality and then accountability, this would be not expected and is a cause for concern.

Questionnaire results reveal the overall perception of stakeholders toward earnings management ethics. Unlike the interview findings, earnings management according to the questionnaire results is perceived, on balance, to be unethical. However, it is notable that stakeholders' views are almost equally split on the ethics of earnings management with no statistically significant difference in aggregate views between different groups of stakeholders as shown in Table 8.1. This may raise concerns about the accountability process given the potential implications of such behaviour on various stakeholders. The financial information, according to the accountability framework, should be objectively presented in order to be useful and fair to all stakeholder groups.

As reported in Chapter 2, the accountability concept in a Muslim country, like Libya, is different from that applied in the West where the companies are only responsible and therefore accountable to their stakeholders and in particular to shareholders. In an Islamic country, firms as well as individuals should be held accountable not only to their stakeholders, but to God. Each Muslim is explicitly held responsible and accountable to God for everything he/she does including commercial activities given the fact that Islam is regulating every facet in a Muslim life.

8.2.2.5 Earnings Management Facilitations Factors

During the interviews, some factors have arisen when interviewees were asked about the factors that could influence the extent of earnings management (Q 9, Table 6.1). Most of the views revolved around some key factors: local accounting standards, corporate governance, and the external auditor. These factors and some other more ones were examined in the questionnaire survey.

On average, stakeholders perceived that local accounting practices, ineffective external auditing, and poor corporate governance would make it easy for bank managers to exercise earnings management. In addition to the above factors stakeholders also perceived, on balance, that the lack of business knowledge by users and the ineffective monitoring by the different monitoring bodies (the CBL, LSM, and tax authority) may also encourage bank managers to easily be engaged in earnings management practices.

8.2.2 Perceptions of Stakeholders on How LCBs' Financial Reporting Quality Can be improved

Both interviewees and the questionnaire respondents were asked about their perceptions in regard to how could LCBs' financial reporting be improved by applying a certain set of procedures. Both interview findings and questionnaire results showed, on balance, agreement that such procedures (as discussed below) are seen to positively influence the quality of LCBs' financial reporting and therefore their accountability mechanism would be improved. The discussion below summarises the interview findings as well as the questionnaire results in respect of these procedures.

8.2.2.1 IFRS and Financial Reporting Quality

The applying of IFRS by LCBs is seen by most interviewees (75%) to have a positive impact on LCBs' financial reporting. Therefore, the accountability process of LCBs would be improved, it was thought, if IFRS is implemented. This finding is in agreement with the questionnaire results in this respect.

IFRS is perceived, in particular, by the questionnaire respondents to have an influence on LCBs' financial reporting quality. LCBs' stakeholders agreed, on average, that adopting IFRS may mitigate the practice of earnings management by LCBs' managers which ultimately may promote the accountability process of LCBs. Without such a framework it could be difficult to satisfy characteristics of verifiability and stability. For example, if two accountants were to produce financial statements using the same accounting data, they would probably reach a very similar outcome if there was a framework. The importance of a framework has been stressed by some interviewees, for example, AD3 indicated that the absence of accounting standards would lead to accounting manipulation. Another evidence on the importance of the framework provided from RG9 who stated that absence of accounting standards resulted in low financial reporting quality and that there is indeed a need to an accounting framework even written on a cement bag. He said:

"The financial reporting quality is very weak. Moreover, there is no difference in the quality between listed and unlisted companies because of no accounting standards. All we have is the broken record that is "according to GAAP" which we don't have any definition of so that we can be clear on what is meant when someone uses this expression. No one exactly knows what the term GAAP means. When you and I disagree we don't have any reference that we go to so we should have a written GAAP, no matter if even written on a cement bag. Thereby, the quality is zero due to no accounting standards".

The evidence provided by this study, that IFRS may improve the financial reporting quality and thereby accountability, is consistent with a wide stream of scholars who believe IFRS would mitigate earnings management practices and therefore promote financial reporting quality.

8.2.2.2 Corporate Governance and Financial Reporting Quality

Accountability as explained earlier in Chapter 4 is perceived as being a golden concept that everyone is agreeing with and that corporate governance as a term may refer to accountability or virtuous behaviour (Bovens, 2007 and 2010).

Most of the interviewees had the view that applying good corporate governance would improve the financial reporting quality of LCBs. The majority of interviewees (89) had the view that if good corporate governance was applied, the exercise of earnings management practices by LCBs' managers would be deterred. This finding comes in line with stakeholders' perceptions examined by the questionnaire survey as well. However, interview findings as well provided evidence that corporate governance may well be seen by some stakeholders as a barrier. PR1, for example, the chairman of a commercial bank completely dismissed the value of corporate governance in general. He also thought that it is not applicable in Libya due to the fact of the lack of qualification from which Libya suffers. He said:

"I am against corporate governance, … and splitting between functions in Libya as there is no corporate governance and they couldn't split them due to no qualifications. For me it is nonsense, theory only. But if it is implemented in a good way it would tackle the earnings management".

This evidence is consistent with Coy et al. (2001) who indicate that accountors may seek some ways in order to avoid some constraints, they said:

> "Accountability may be related to power relationships between accountors and accountees within organizations, and in society as a whole. More accountability may limit the freedom of agents to act, and as a consequence, they may seek ways to subvert, bypass, and control accountability systems that may be imposed on them. Agents generally control the preparation of accountability information reported to principals, and this provides opportunities for massaging, which may exaggerate strengths and understate weaknesses" (p. 8).

LCBs' stakeholders showed, on balance, agreement towards the impact of applying good corporate governance on financial reporting quality. It would limit the practice of earnings management by LCBs' managers which, arguably, results in higher quality financial reporting and therefore, accountability would be enhanced.

8.2.2.4 External Auditing and Financial Reporting Quality

The external auditor represents a key element in the accountability mechanism. Their important role, providing assurance and improving credibility of the financial statements, increases the public confidence in respect of the reliability and relevance of the provided financial information. It arguably can be said that quality audit would reduce or prevent earnings management practices thus provided financial information would be of good quality and ultimately one can argue good audit quality has a crucial role in promoting the accountability system. As mentioned in Chapter 2 and 4, only registered auditors with the CBL are authorised to perform banks audit which implies a certain level of audit quality is required by the CBL. Based on this one could expect that good audit quality is being carried out in LCBs and therefore LCBs' financial reporting is of a reasonable level of quality i.e. unbiased accounting information is being provided.

Interviewees were asked to assess the role of the external auditor in respect of earnings management by LCBs' managers. Although they expressed the view that registered auditors are able to detect earnings management practices of LCBs, they were doubtful about the ability of the external auditor when it comes to preventing or deterring the practices due to a number of reasons including the audit fee. 89% of interviewees had the view that auditor is able to detect earnings management but 75% of them thought that the auditor is unable to prevent such a practice. Some other issues were referred to as reducing the external auditor's ability to detect or prevent earnings management, these were: lack of knowledge, limited experience, conflict of interest, and audit sampling.

The role of the external auditor was examined in more detail by the questionnaire survey. The external audit function is related to the accounting standards as it is the auditor's job to ensure financial statements have been prepared in accordance with the adopted framework i.e. accounting standards. As reported earlier, the lack of accounting standards in Libya would make such a mission a challenging task in many aspects: lack of a framework leads to financial information being instability, the accounting practices applied in one year may not be applied in the next period or it may happen two banks apply different practices. Also the verifiability characteristic would not be an easy task, absence of accounting standards will potentially lead to different outcomes if financial information was to be produced by another accountant. The lack of accounting standards may also open the door for managers to apply any accounting practice that serves their own benefit and present the financial statement in a favourable position to their stakeholders. To sum up it could arguably said that deficient, or lack of, standards lead to a deficient audit function.

As discussed earlier, questionnaire respondents were asked to assess the impact of some factors that may ease the exercise of earnings management by LCBs' managers, and two of these were related to the auditor. Questionnaire results showed, on balance, agreement by LCBs' stakeholders that the ineffective function of the external audit as well as difficulty of detecting earnings management by auditors may be reasons why earnings management is taking place in LCBs' financial reporting. Another result revealed stakeholders' agreement that educating the external auditor may have a positive impact over the external auditor's ability to deter earnings management behaviour. This result lead to the assumption that listed auditors are not trained and educated enough to detect the behaviour. However this is not in line with the interview findings which refer to the view by the majority of interviewees who had the view that the problem with the external auditor (in respect of earnings management) is to deter it rather than detect it. This conflict in views between the interview findings and questionnaire results is confirmed again when questionnaire respondents showed, on balance, agreement that listed auditors are well qualified to perform banks' audit. Moreover, questionnaire results reveal that listed auditors are relatively (on balance) in a good position that enables them to detect and deter earnings management practices of LCBs' managers. The power by which listed auditors are able to deter earnings management practices, according to the questionnaire results, comes from the auditor's report. Another area of disagreement arose between the interview findings and the questionnaire results. Interviewees had the view that listed auditors are unable to deter earnings management practices referring to some issues to support this notion, e.g. audit fees and the lack of significance of the external auditor report since in some cases it is only regarded as a legal requirement. On the other hand, questionnaire respondents agreed, on balance, that audit fees may lead to compromising the auditor's ability to report on earnings management, but that the auditor's report is being used to deter the practice which contradicts some interviewees' perceptions. This potentially may lead to assumption that the relationship between the auditor and the various groups of stakeholders which may indicate a wide accountability notion that listed auditors are aware of as will be discussed in the next section.

In more detail, questionnaire respondents were asked more questions regarding the external auditor. LCBs' stakeholders showed, on balance, agreement that the external auditor is aware of his/her accountability to shareholders and other parties and also that the auditor's report is not only a legal requirement but is being widely used by various stakeholders unlike the views given in interviews. Specifically, questionnaire results showed, on average, unexpectedly[108] wide agreement between respondents that the auditor's report is being used by: shareholders, management, employees, tax authority, customers, the LSM, the CBL, corresponding banks, media, academia, and society as a whole.

Although questionnaire results in many aspects come in favour of the current status of the bank audit function, unlike interview findings, however LCBs' stakeholders acknowledged the weak regulation that govern the audit function as well as lack of oversight of the financial reporting function. They agreed, on balance, to the need to strengthen both audit regulation and oversight of financial reporting.

Within accountability framework, accounting information should be characterised of being 'verifiability'. This simply means accounting information when reproduced it would come to the same conclusion. This mission, partially, done by auditors who will review, re-perform, and re-calculation some accounting information in order to verify it. This job would not be as easy as one may think when the audit profession itself is below the level i.e. not well organised and strengthened.

This may lead to a conclusion that in order to enhance the accountability process of LCBs, efforts should be paid to enhance the audit function by strengthening it through legislation. Also, the oversight of the financial reporting function, which does not exist at the moment, should be established so that the accountability system is enhanced.

[108] It could arguably said, based on self-experience of the researcher, that not all stakeholders would deal with auditor's report properly e.g. tax department in many cases ignores the auditor's report. Also other stakeholders e.g. employees, customers, media and society according to researcher's experience do not deal with it. Media and society for example have only recently become affective and it was not adequate time to judge about them.

8.4 Limitations and the Problems of Conducting the Research

Despite the attempts afforded to get this study to achieve its objectives, this thesis, like any other social research, was subject to some certain limitations. First of all, the research has coincided with 17th Feb Revolution in Libya. The study started in Sep 2010 when Libya was relatively stable, until the embarking of the "17th Feb Revolution" which started on 15th[109] Feb 2011 and officially came to end on 23th Oct 2011 when the country was announced as being liberated[110]. This affected this study in two aspects: firstly the researcher was concerned about family and relatives as there were no contacts available; secondly this affected the study in terms of data collection. Interviews were undertaken as reported in Chapter 6, firstly in Benghazi and then in Tripoli after liberation. However, it could be said that the number of interviews could have been raised in more stable and better conditions. Only 28 interviews were conducted and 192 usable questionnaires were returned and analysed. As normal when adopting such approaches this may not reflect the perspective of the entire population of LCBs' stakeholders. In addition, one of the stakeholder groups, Users was particularly small, consisting of only two interviewees, all academic, and there were 28 Users in the questionnaire survey 15 of whom were from academic positions.

Another limitation that might have occurred concerns the potential bias of some participants; Preparers might try to create a favourable impression regarding the financial reporting of their firms, while auditors may have given a positive evaluation when it came to assessing the role of the external auditor.

The position of the researcher, as an external auditor, may also act as a limitation. It has been noticed during some interviews that some Preparers tried to give a good impression

[109] It was planned to start revolution on 17th Feb, the date when a demonstration started in Benghazi in 2006 against the Italian ministry who appeared on TV showing the photo of who made the film that abusing our Prophet Mohamed, but the Libyan police by time arrested a human rights campaigner who used to guide demonstrations against the regime in Benghazi which provoked people against the regime and start the Revolution (BBC, 2012a).

[110] However, up to date of writing this thesis the security status of the country remains unstable.

about their work places. Also some Auditors' responses during interviews could have been affected by this fact as they may have seen the researcher as a competitor and therefore have been reticent about sharing some information about their clients.

The topic itself may also represent a limitation to this study. As was apparent from interview findings, as well as the questionnaire results, earnings management is a new topic. Due to this unfamiliarity, some interview questions were left unanswered, while other questions that related to earnings management techniques were answered with lack of understanding of the topic as some interviewees mixed it with fraud and provide some techniques that completely out of GAAP and laws.

The questionnaire survey itself may represent a limitation. Answering qualitative questions might be challenging for some so they may be tempted to provide random answers to finish quickly. Despite efforts afforded to make a reasonable length questionnaire it looked long and apparently time consuming for some as a number of questionnaires were returned uncompleted and those were excluded.

Notwithstanding the above limitations, the study provides evidence of the state of LCBs' financial reporting quality and accountability by addressing the topic of earnings management specifically. It also addressed related issues including the influence of IFRS, corporate governance, and the external auditor in respect of LCBs financial reporting quality and accountability.

8.5 Contribution to Knowledge

This study aims to advance the earnings management practices research of the banking industry in the Libyan context. It addressed stakeholders' perceptions of the phenomenon of earnings management in LCBs and how such a practice could be implemented and why it may occur. Also, the ethics of managing earnings as well as factors that may enable LCBs' managers to easily exercise this behaviour was considered. The impact of: adopting

IFRS, applying good corporate governance, and the role of the external auditor were also discussed. The findings of this study are interpreted from an accountability perspective which may potentially be seen as a contribution. Many studies on earnings management have been carried out based on other theories other than accountability. Habbash (2010), for example, examined the effectiveness of corporate governance and external audit on earnings management practices in the UK using agency theory. Also, Alghamdi (2012) carried out a study to investigate earnings management practices by Saudi listed companies using both agency theory and institutional theory. However, with referring to the importance and impact of the banking sector not only to shareholders but to all stakeholders and society as a whole such a framework may lead to protect their rights. One of the interviewees, US1, mentioned that in the event of a commercial bank collapsed it is customers group who will be affected the worse being. He indicated:

> "The main stakeholder in my opinion is not the shareholder. … However, when the bank is collapsed, it is the clients who will suffer more than shareholders. Theoretically the main stakeholder is the shareholder but practically it is the customer. If the bank had gone bankrupt the customer would lose much more than shareholders; this is the case in Libya

The current findings may assist to fill the gap in the literature in respect of earnings management practices in Libya in general and in Libyan Commercial Banks (LCBs) in particular. There is a wide literature on earnings management in developed countries. However, relatively little is dedicated to developing countries. Due the fact of differing environmental factors between developed and developing countries such study should be of interest to research on developing countries in general and in Libya in particular. To the best of researcher's knowledge it is the first study of its kind that dealt with LCBs' financial reporting.

The current study findings highlighted the problem of misinterpretation of the term 'earnings management', it then contributes to knowledge by providing a general understanding of how such a term could be considered in a developing country like Libya and drew attention to the fact of inaccurate translation of terms from English to Arabic. Such translation should be based on meaning rather than being a literal translation.

This study provides evidence on current earnings management techniques that LCBs are thought to be using. This contribution to the knowledge is potentially of great interest to all stakeholders given the importance of the financial reporting quality and accountability. In particular, Auditors who have a key role in the accountability process and Regulators whose LCBs financial reporting lay in their concerns would benefit a lot through understanding how such a topic would affect the quality of LCBs' financial reporting and therefore their roles. According to Beaudoin et al. (2013), the practice of earnings management has led regulatory changes as a response the downfall of some high profile corporations that have been engaged in such a practice. In particular, Regulators of commercial banks may be concerned, according to Cohen et al. (2014, p. 174), with LLP. The recording of LLP has a direct impact on reported earnings therefore regulators view LLP as a "type of capital that can be used to absorb losses".

8.6 Future Research Avenues

A very few studies have been conducted in Libya in regards to earnings management behaviour in general and on the banking sector in specifically. Although the current study aimed to shed light on such an issue, more research is needed so that such an important topical issue is well known at least amongst the financial community.

The present study investigated the perceptions of various stakeholders, including User who consisted of people who are involved directly or in directly with the financial reporting of LCBs. Due to instability which the country was –and still- suffering it only few shareholders were approached. The researcher's attempts through LSM to get in touch with some more investors ended up with no result.

Future research may also focus on the ethics of earnings management by approaching different stakeholders including accounting students. It could also be recommended to think about including such topic in text books as well as business ethics. The present study provides evidence on the need for educating and training of preparers, auditors, and investors. However future research may seek proper ways on how to perform the training and education.

However, future research may focus more on the appropriateness and suitability of adopting IFRS in the Libyan environment as well as detailed research on corporate governance of LCBs as related to the earnings management phenomenon, for example, the role of internal audit in respect to earnings management, the effectiveness of audit committee, and the function of board of directors.

The recent financial crises have reflected the importance of the quality of financial reporting and accountability. Managers should be held accountable not only to shareholders but to a wide range of stakeholders. In the banking sector the stakeholders list would include, for example, depositors who will arguably suffer the most in the event of collapse and when bank managers are not properly held accountable. Therefore, the importance of accountability should be acknowledged, and improved through promoting the quality of financial reporting for the benefit of society as a whole.

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Appendices

Appendix 6.1

Interview Questions List (English)

1- What is your opinion about the overall quality of financial reporting in Libya, particularly for listed companies?
2- Why is financial reporting important? Who is it important to?
3- Are you familiar with the term earnings management?
4- What do you understand by the term earnings management?
5- Do you think that earnings management is practiced in Libya and if so, to what extent?
6- In particular, do you think that earnings management is practiced in the banking sector and if so, to what extent?
7- Who do you regard as the main stakeholders in banks?
8- Are you aware of any techniques that may be used to manage earnings both generally and particularly in the banking sector?
9- Which factors do you think may influence the extent of earnings management?
10- What in your view are the possible motives for earnings management both in general and in the banking sector?
11- How do you perceive the practice in terms of business ethics?
12- Do you think that absence of local accounting standards influence the practice of earnings management?
13- Do you think that adopting IFRS could affect earnings management? How?
14- Could you comment on the impact of good corporate governance in relation to earnings management?
15- Could you comment on the ability of external audit function to detect and/or deter earnings management?
16- What is you assessment of the effectiveness of external audit of banks in Libya?
17- To what extent do you think that stakeholders rely on the auditor’s report?
18- Do you have any other view on the topic of earnings management in the Libyan banks?
19- Do you think that accounting manipulation could be used in other ways to mislead the stakeholders e.g. in relation to capital adequacy and overall financial position?

Appendix 6.2

Interview Questions List (Arabic)

1- ما هو تقييمكم لمستوى جودة التقارير المالية فى ليبيا وخصوصا للشركات المقيدة بسوق الاوراق المالية؟

2- لماذا برأيك يعتقد أن التقارير المالية مهمة؟ ولمن تعتبر مهمة؟

3- هل سمعت عن مصطلح إدارة الأرباح؟

4- ماذا تفهم من عبارة "إدارة الارباح"؟

5- هل تعتقد بتطبيق او ممارسة إدارة الأرباح فى ليبيا؟ والى أى مدى؟

6- على وجه الخصوص، هل تعتقد أن المصارف الليبية تقوم بإدارة الأرباح؟ والى أى مدى؟

7- من برأيك الطرف أو الأطراف الرئيسية (stakeholders) بالنسبة للمصارف؟

8- هل لديك أى فكرة عن كيفية إدارة الأرباح فى الشركات بصفة عامة والمصارف بصفة خاصة؟

9- ما هى العوامل برأيك التى قد تحد من إدارة الأرباح؟

10- ما هى برأيك الدوافع المحتملة لإدارة الأرباح عموما وفى القطاع المصرفي بصفة خاصة؟

11- كيف تنظر الى هذا السلوك فيما يتعلق بأخلاق العمل (business ethics)؟

12- هل تعتقد أن غياب المعايير المحاسبية المحلية يؤثر على إمكانية ممارسة إدارة الأرباح؟

13- هل تعتقد بأن تطبيق المعايير الدولية يمكن أن يؤثر فى إمكانية تطبيق إدارة الارباح؟ كيف؟

14- ما هو تعليقك على تأثير تطبيق الحوكمة الجيدة على إدارة الأرباح؟

15- ما هو تعليقك على قدرة المراجع الخارجى فى إكتشاف ومنع تطبيق إدارة الأرباح؟

16- ما هو تقييمك لكفاءة المراجع الخارجي للمصارف؟

17- الى أى مدى فى اعتقادك يعتمد المستخدمين والاطراف الاخرى على تقرير المراجع الخارجى؟

18- هل لديك أى وجهة نظر أخرى حول موضوع إدارة الارباح؟

19- هل تعتقد أن الحيل المحاسبية أو التلاعب بالحسابات (accounting manipulation) يمكن استخدامها لتضليل المستخدمين والاطراف الاخرى، على سبيل المثال فيما يتعلق بكفاية رأس المال والمركز المالى بصفة عامة؟

Appendix 7.1

Questionnaire Survey (English)

School of Business

Quality of Financial Reporting in the Libyan Commercial Banks

Dear participant

I am conducting research, in collaboration with Prof. David Collison and Dr. Louise Crawford at the University of Dundee (UK). The study examines the issue of “Earnings Management” in the context of Libyan Commercial Banks from the perspective of various stakeholders. In order to have insightful results, your participation in filling in this questionnaire would be highly appreciated. I therefore, would be most grateful if you would complete this questionnaire and please be assured that the information you provide in this questionnaire will be treated in complete confidence and responses will only be reported in aggregate with no individual responses being identified. If you have any questions please feel free to contact me at the email address or phone numbers below.

Thank you in anticipation for your participating in this survey

Yaser Saleh

For any information, please contact the researcher at:
y.saleh@dundee.ac.uk
Mobile: +218(91)3262155
+44(77)33373971

Part 1 :General Information (Please respond by ticking (√) in the appropriate box)

Please indicate your age

Less than 25 years old	Between 26 and 30 years old	Between 31 and 40 years old	Between 41 and 50 years old	Over 50 years old

1.1 Please indicate your gender: M ( ) F ( )

2. Are you professionally qualified in accountancy or finance? Yes ( ) No ( )

If yes, please indicate which of the following professional qualifications that you have:

Professional Body	
LAAA	
ICAEW	
CIMA	
ACCA	
AICPA	
Other, please specify ….	

3. What is your highest educational qualification?

Qualification	
Diploma	
Bachelor degree	
Master degree	
Doctorate	
Other, please specify ………	

4. Please indicate your place of education for your highest degree

Place	
Libya	
Other Arab country	
UK	
USA	
Other, please specify ………	

5. Please tick your place of work and position

Place of Work		position
A commercial bank		
Central Bank of Libya		
The Libyan Stock Market		
Tax Authority		
Audit Firm		
State Audit		
Current or potential investor		
Academia and Research Centres		
Other, please specify ………		

6. Please indicate the work experience, if any, that you have:

Less than 5 years		Between 5 and 10 years	
Between 11 and 15 years		Over 15 years	

7. Where applicable, please describe any work experience that you have had in the Libyan banking sector (e.g. accountant for 5 years, internal auditor for 3 years)

Part 2: Financial Reporting Quality and Earnings Management

For the purpose of this questionnaire, financial reporting is defined as being of good quality when it provides useful information to the users of financial statements.

2.1 Please indicate the extent to which you agree or disagree, with the following statements about the quality of financial reporting in Libya.

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Financial reporting, generally, is of good quality					
Financial reporting of listed companies is of good quality					
Financial reporting of banks generally is of good quality					
Financial reporting of listed banks is of good quality					
Financial reporting by listed banks provides relevant information					
Financial reporting by listed banks provides reliable information					

2.2 Are you familiar with the term “Earnings Management?”

Yes ( ) No ( )

2.3 To what extent do you agree or disagree with the following statements about earning management:

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Earnings management means reinvesting the earned profits					
Earnings management means manipulating earnings					
Earnings management is a bank activity which is responsible for planning and controlling reported income					
Earnings management means Increasing or decreasing the reported income according to management’s desire					
Other, please specify ………………………					

For the purpose of this questionnaire, "Earnings management" is defined as the manipulation of the externally reported income statement to alter the reported income according to management's desire. [Such adjustments may take place within GAAP but in some cases they could be done in breach of GAAP]. Such manipulation is widely known as 'earnings management' in the professional and academic accounting literature in the US and UK.

2.4 Such earnings management would, according to the literature, affect the quality of financial statements; to what extent do you agree or disagree with the following statements about the Libyan commercial banks:

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Earnings management affects the quality of financial statements					
Earnings management is practiced in the private listed banks.					
Earnings management is practiced in the private unlisted banks.					
Earnings management is practiced in the listed state-owned banks.					
Earnings management is practiced in the unlisted state-owned banks.					
Managers are managing earnings to manipulate information communicated to shareholders					
Managers are managing earnings for their own benefits					
Earnings management enables managers to better communicate economic information to stakeholders					
Managers are managing earnings to manipulate information communicated to the regulators					
Managers are managing earnings to manipulate information communicated to credit rating agencies					

2.5 please indicate to what extent you agree or disagree that bank managers are paying most attention to the following users when it comes to preparing financial statements

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Stakeholder	SD	D	NAD	A	SA
Shareholders					
Employees					
Current and potential costumers					
Central Bank of Libya					
Tax authority					
The Libyan Stock Market					
Corresponding banks					
Bank credit rating agencies					
Media					
Academia and research centres					
Society as a whole					
Other, please specify …………………………..					

2.6 Please indicate to what extent you agree or disagree that the following factors motivate Libyan commercial bank managers to manage earnings:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Motivation	**Ownership**	SD	D	NAD	A	SA
Management compensation	State					
	Private					
Job security	State					
	Private					
To avoid regulatory interventions	State					
	Private					
The desire to report smooth earnings	State					
	Private					
To influence other stakeholders	State					
	Private					
Because other Libyan banks manage earnings	State					
	Private					
To avoid reporting losses	State					
	Private					
To meet predetermined expectation (budgets)	State					
	Private					
To decrease tax payments	State					
	Private					
To influence assessment by credit rating agencies	State					
	Private					
To influence stock price	State					
	Private					
Other, please specify ……………………..						

Please comment, if you think that listed and unlisted status would influence your response to any of the above factors:

2.7 Please indicate to what extent you agree or disagree that the following areas or techniques may be used by Libyan commercial bank managers to manipulate reported earnings.
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Method	SD	D	NAD	A	SA
Reserves					
Revenue recognition					
Disposing of high market value assets					
Investments					
Concealing losses					
Use or misuse of set-aside interests[111]					
Accounting changes					
Foreign currency					
Manipulation of the loan loss provision					
Other means, please specify …………………					

2.8 please indicate to what extent you agree or disagree that the following factors enable Libyan commercial bank managers to manipulate earnings:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Factor	SD	D	NAD	A	SA
Local accounting practice					
Ineffective external audit function					
Poor corporate governance mechanism					
Poor commercial and business knowledge among users					
Ineffective monitoring by Central Bank of Libya					
Ineffective monitoring by Libyan Stock Market					
Ineffective monitoring by Tax authority					
Difficulty of detection by auditors					
Difficulty of detection by users					
Other, please specify …………………..					

2.9 To what extent do you agree or disagree that the following actions would mitigate the practice of earnings management:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Action	SD	D	NAD	A	SA
Adopting international accounting standards (IFRS) in practice					
Applying good corporate governance e.g. existence of audit committee, effective internal auditing…					
Educating and training of preparers					
Educating and training of auditors					
Educating and training of investors					
Strengthen audit regulation					
Strengthen oversight of financial reporting					
Other, please specify ……………………………					

[111] Set-aside interests. Literal translation for interests that are calculated and booked as a provision rather than revenue because of a client bad debt risk.

2.10 To what extent, do you agree or disagree with the following statements concerning the ethics of earnings management:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Ethical behaviour means complying with law					
Ethical behaviour means thinking about the impact of one's decisions on others					
Earnings management is ethical if practiced within the law					
Earnings management is ethical if practiced within the GAAP					
Earnings management affects others' interests					
Earnings management is an unethical practice					

Part 3: External Auditor

3.1 According to Libyan regulations, only auditors who are listed with the Central Bank of Libya are allowed to audit Libyan commercial banks. This restriction implies that those "listed auditors" are qualified to undertake an effective audit for banks. To what extent do you agree or disagree with the following statements:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Listed auditors, in practice, are well qualified and capable to audit banks					
The auditor's report is relied upon when assessing a bank's financial performance					
Listed auditors are likely to detect and deter earnings management practices in Libyan commercial banks					
An auditor's ability to report on earnings management is compromised by audit fess					
An auditor's willingness to report earnings management breaches is compromised by confliction of interest to an auditor's independence					
The external auditor can prevent the practice of EM using the power of the auditor's report					

3.2 Please indicate the extent by which you agree or disagree with the following statements:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
External auditors are fully aware of their accountability to the shareholders					
External auditors are fully aware of their accountability to the third parties					
The auditor's report is widely used by interested stakeholders					
The auditor's report is only a legal requirement and not used widely in the financial decision making process.					

3.3 Presumably, an auditor's report is used by several parties when making economic decisions regarding financial statements. Please indicate to what extent do you agree or disagree that the following stakeholders place greater trust in financial statements of Libyan commercial banks as a result of the auditor's report than they would otherwise do:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Users	SD	D	NAD	A	SA
shareholders					
Management					
Employees					
Tax department					
Current and potential customers					
The Libyan Stock Market					
Central Bank of Libya					
Corresponding banks					
Media					
Academia and research centres					
Society as a whole					
Other, please specify ………………					

Part 4: Additional Information
4.1 Please use the space below to make any comments about the earnings management practices in the Libyan Commercial Banks

The researcher would like to take the opportunity to thank you for filling in the questionnaire. Also, if you would like to receive a summary of the research results and findings please write down your name and contact details. Thank you.

Name	
Address	
Email	
Phone number	
Fax number	

Appendix 7.2

Questionnaire Survey (Arabic)

DUNDEE

School of Business

إستمارة إستبيان حول جودة التقارير المالية في المصارف التجارية الليبية

المشارك الكريم

يقوم الباحث بالتعاون مع البرفسور ديفيد كوليسون والدكتورة لويس كراوفورد بجامعة دندي (المملكة المتحدة) بدراسةٍ عن إدارة الأرباح فى المصارف التجارية الليبية من منظور أصحاب المصالح المعنيين. إن تعاونكم الكريم بملء هذه الإستمارة سيكون له الأثر الطيب والإيجابي للوصول إلى نتائج الدراسة. كما أؤكد أن كل المعلومات التى ستدلون بها سوف تعامل بسرية تامة ولن تستخدم إلا فى أغراض البحث العلمي.

أشكركم مقدماً على تعاونكم بتخصيص جزءٍ من وقتكم الثمين للإجابة على أسئلة الإستبيان.

ياسر محمد البرغثى

لأي استفسار يرجى الإتصال على العنوان:

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هاتف: 0913262155 - (44)7733373971

إستمارة إستبيان حول جودة التقارير المالية في المصارف التجارية الليبية

الجزء الأول: معلومات عامة عن المشارك

يرجى الإجابة بوضع علامة (√) فى الخانة المناسبة كما هو موضحٌ بعد كل سؤال.

1. يرجى تحديد العمر:

أقل من 25 سنة	من 26 حتى 30 سنة	من 31 حتى 40 سنة	من 41 حتى 50 سنة	أكثر من 51 سنة

2. هل تحمل مؤهلاً مهنياً فى المحاسبية؟ نعم ( ) لا ( )

إذا كانت الإجابة بنعم، يرجى تحديد المؤهل:

نقابة المحاسبين والمراجعين الليبيين	ACCA	AICPA	ICAEW	CIMA	أخرى، يرجى التحديد

3. ما هو آخر مؤهل تعليمى تحصلت عليه؟

دكتوراة	ماجستير	بكالوريس	دبلوم	مؤهلات أخرى، يرجى التحديد

4. يرجى تحديد المكان الذى تحصلت منه على هذا المؤهل:

ليبيا	بلد عربي آخر	المملكة المتحدة	الولايات المتحدة الامريكية	أخرى، يرجى التحديد

5. يرجى تحديد مكان العمل والوظيفة:

مكان العمل	
مصرف تجاري	
مصرف ليبيا المركزي	
سوق الأوراق المالية	
إدارة الضرائب	
مكتب مراجعة	
ديون المحاسبة	
مستثمر أو مساهم	
أكاديمي	
أخرى، يرجى التحديد	

6. يرجى تحديد سنوات الخبرة فى مجال العمل المصرفي:

أقل من خمس سنوات	من 6 إلى 10 سنوات	من 11 إلى 15 سنة	أكثر من 15 سنة

7. يرجى بيان مجال ومدة الخبرة المكتسبة فى القطاع المصرفي (على سبيل المثال، محاسب لمدة 5 سنوات أو مراجع داخلي لمدة 3 سنوات)

الجزء الثاني: جودة التقارير المالية وإدارة الأرباح

لأغراض هذه الدراسة، تعتبر التقارير المالية ذات جودة إذا كانت تقدم معلومات مفيدة لمستخدميها.

1.2 يرجى الاشارة إلى أيِّ مدى توافق أو لا توافق على العبارات التالية بخصوص جودة التقارير المالية فى ليبيا:

العبارة	لا أوافق بشدة	لا أوافق	محايد	أوافق	أوافق بشدة
تعتبر التقارير المالية فى ليبيا بصفة عامة ذات جودة					
تعتبر التقارير المالية للشركات المقيدة بسوق المال ذات جودة					
تعتبر التقارير المالية للمصارف التجارية بصفة عامة ذات جودة					
تعتبر التقارير المالية للمصارف المقيدة بسوق المال ذات جودة					
تعتبر المعلومات المالية للمصارف المقيدة ملائمة لاتخاذ القرارات					
تعتبر المعلومات المالية للمصارف المقيدة موثوقة عند اتخاذ القرارات					

2.2 هل سمعت عن مصطلح "إدارة الأرباح"؟ نعم ( ) لا ( )

3.2 الى أى مدى توافق او لا توافق أن مصطلح "إدارة الأرباح" يحمل المعنى التالي:

المعنى	لا أوافق بشدة	لا أوافق	محايد	موافق	موافق بشدة
إعادة إستثمار الأرباح المحققة					
التلاعب بالأرباح					
أحد أقسام المصرف مهمته التخطيط والرقابة على الأرباح					
زيادة أو تخفيض صافى الدخل					
أخرى، يرجى التحديد					

لأغراض الدراسة، *تعرف إدارة الأرباح على أنها تلاعب الإدارة بقائمة الدخل بغرض تعديل صافى الدخل حسب رغبة الإدارة. مثل هذه التدخلات يمكن أن تتم من خلال معايير المحاسبة المقبولة والمتعارف عليها، إلا أنه فى بعض الحالات يتم تطبيقها بالمخالفة لهذه المعايير. يعرف هذا التصرف على نطاق واسع فى الأدب المهنى والأكاديمى فى الولايات المتحدة وبريطانيا بإسم "إدارة الأرباح".*

4.2 بحسب الأدب المحاسبي فإن إدارة الأرباح تؤثر على جودة القوائم المالية، **إلى أيِّ مدى توافق أو لا توافق على ما يلي:**

العبارة	لا أوافق بشدة	لا أوافق	محايد	موافق	موافق بشدة
تؤثر إدارة الأرباح على جودة التقارير المالية					
تقوم المصارف الخاصة المقيدة لدى سوق الأوراق المالية بممارسة إدارة الأرباح					
تقوم المصارف الخاصة غير المقيدة لدى سوق الأوراق المالية بممارسة إدارة الأرباح					
تقوم المصارف العامة المقيدة لدى سوق الأوراق المالية بممارسة إدارة الأرباح					
تقوم المصارف العامة غير المقيدة لدى سوق الأوراق المالية بممارسة إدارة الأرباح					
تقوم إدارة المصرف بممارسة إدارة الأرباح بقصد التلاعب بالمعلومات الموجهة للمساهمين					
تقوم إدارة المصرف بممارسة إدارة الأرباح لتحقيق منافع خاصة					
من خلال تطبيق إدارة الأرباح يمكن للإدارة إظهار النتائج الحقيقية للمصرف					
تقوم الإدارة بممارسة إدارة الأرباح لغرض التلاعب بالمعلومات الموجهة للجهات الرقابية					
تقوم الإدارة بممارسة إدارة الأرباح لغرض التلاعب بالمعلومات الموجهة لوكالات التصنيف الإئتمانى					

5.2 الى اى مدى توافق او لا توافق أن إدارة المصرف تولي إهتماماً أكبر بفئات المستخدمين التالية عند إعداد القوائم المالية:

الفئة	لا أوافق بشدة	لا أوافق	محايد	أوافق	أوافق بشدة
المساهمون					
الموظفون					
الزبائن الحاليون والمتوقعون للمصرف					
مصرف ليبيا المركزي					
إدارة الضرائب					
سوق الأوراق المالية					
المصارف المراسلة					
وكالات التصنيف الإئتمانى للمصارف					
الإعلام					
المؤسسات الأكاديمية ومراكز البحوث					
المجتمع بصفة عامة					
فئة أخرى، يرجى التحديد					

6.2 يرجى تحديد إلى أيّ مدى توافق أو لاتوافق أن الأسباب التالية تمثل دافعا لإدارة المصرف للقيام بإدارة الأرباح:

الدافع	الملكية	لا أوافق بشدة	لا أوافق	محايد	موافق	موافق بشدة
مكافآت الإدارة	عامة					
	خاصة					
الحفاظ على الوظيفة	عامة					
	خاصة					
تجنب تدخل الجهات الرقابية	عامة					
	خاصة					
الرغبة فى إظهار الأرباح بشكل متناسق مع الفترة السابقة	عامة					
	خاصة					
للتأثير على بعض أصحاب المصالح كالزبائن أو الموظفين	عامة					
	خاصة					
قناعة إدارة المصرف بأن المصارف الأخرى تقوم بممارسة إدارة الأرباح	عامة					
	خاصة					
لتجنب إظهار خسائر	عامة					
	خاصة					
إظهار النتائج بما يتوافق مع الميزانية التقديرية	عامة					
	خاصة					
لتخفيض قيمة الضرائب المستحقة على أرباح المصرف	عامة					
	خاصة					
لتحسين التصنيف الإئتمانى	عامة					
	خاصة					
للتأثير على سعر السهم في سوق الأوراق المالية	عامة					
	خاصة					
دوافع أخرى، يرجى التحديد						

إذا كانت إجابتك عن الأسئلة السابقة ستتأثر بحسب كون المصرف مقيد أم غير مقيدٍ لدى سوق الأوراق المالية يرجى استخدام الفراغ التالي للتعليق:

7.2 يرجى الإشارة إلى أيِّ مدى توافق أو لا توافق على قيام إدارة المصرف بإستغلال الطرق والوسائل التالية لتطبيق إدارة الأرباح:

الطريقة	لا أوافق بشدة	لا أوافق	محايد	أوافق	أوافق بشدة
المخصصات والإحتياطيات					
توقيت الإعتراف بالايراد					
التصرف فى الأصول ذات القيمة السوقية العالية					
الإستثمارات					
إخفاء الخسائر والعمليات ذات الأثر السلبي					
استخدام أو سؤ استخدام الفوائد المجنبة					
تغيير الطرق والسياسات المحاسبية					
أسعار صرف العملات الأجنبية					
التلاعب بمخصص الديون المشكوك فيها					
أخرى، يرجى التحديد					

8.2 إلى أيِّ مدى توافق او لا توافق أن العوامل التالية تُمكن إدارة المصرف من التلاعب بالأرباح:

العامل	لا أوافق بشدة	لا أوافق	محايد	أوافق	أوافق بشدة
معايير المحاسبة المحلية (الممارسات المحاسبية المطبقة فعلياً)					
عدم كفاءة المراجع الخارجي					
ضعف إجراءات الحوكمة					
ضعف المعرفة التجارية والمهنية بين مستخدمى القوائم المالية					
ضعف رقابة ومتابعة مصرف ليبيا المركزي					
ضعف رقابة ومتابعة سوق الأوراق المالية					
ضعف رقابة ومتابعة إدارة الضرائب					
صعوبة اكتشاف إدارة الأرباح من قبل المراجع الخارجي					
صعوبة اكتشاف إدارة الأرباح من قبل مستخدمى القوائم المالية					
عوامل أخرى، يرجى التحديد					

9.2 إلى أيٍّ مدى توافق او لا توافق أن الاجراءات التالية تعتبر مهمة للحد من ممارسة إدارة الأرباح:

الإجراء	لا أوافق بشدة	لا أوافق	محايد	أوافق	أوافق بشدة
تبنى معايير المحاسبة الدولية فعلياً					
تطبيق إجراءات الحوكمة بشكل جيد					
تأهيل وتدريب معدي القوائم المالية					
تأهيل وتدريب المراجعين الخارجيين					
تأهيل وتدريب المستثمرين					
تعزيز مهنة المراجعة					
تعزيز الرقابة على التقارير المالية					
اجراءات اخرى، يرجى التحديد					

10.2 إلى أيٍّ مدى تعتقد بصحة العبارات التالية:

العبارة	لا أوافق بشدة	لا أوافق	محايد	أوافق	أوافق بشدة
التصرف الأخلاقى هو ما يتوافق مع اللوائح والقوانين					
التصرف الأخلاقي يعنى مراعاة أثر القرارات على مصالح الغير					
تعتبر إدارة الأرباح تصرفاً أخلاقياً إذا تم تطبيقها بما لا يخالف القوانين					
تعتبر إدارة الأرباح تصرفا أخلاقيا إذا تم تطبيقها بما لا يخالف المعايير المقبولة والمتعارف عليها					
تؤثر إدارة الأرباح على مصالح الغير					
إدارة الأرباح هى تصرف غير أخلاقي					

الجزء الثالث: المراجع الخارجي

حسب تعليمات مصرف ليبيا المركزي يتولى مراجعة المصارف التجارية المراجعون المقيدون في سجل المراجعين المعتمدين لدى مصرف ليبيا المركزى، وجود سجل للمراجعين المخولين بمراجعة المصارف التجارية يشير إلى أن هؤلاء المراجعين على قدر من الكفاءة تمكنهم من القيام بالمهمة.

1.3 إلى أيٍّ مدى توافق أو لا توافق على العبارات التالية:

العبارة	لا أوافق بشدة	لا أوافق	محايد	موافق	موافق بشدة
المراجعون المقيدون هم فعلا مؤهلون وقادرون على مراجعة المصارف					
يعتمد مستخدمى القوائم المالية بشكل كبير على تقرير المراجع عند تقييم الاداء المالى للمصرف					
يمكن للمراجعون المقيدون اكتشاف وتعطيل إدارة الأرباح					
تتأثر قدرة المراجع على اكتشاف إدارة الأرباح بأتعاب المراجعة					
رغبة المراجع فى التقرير عن إدارة الأرباح قد تتأثر بتضارب المصالح					
يمكن للمراجع ان يمنع إدارة الأرباح من خلال تقريره					

2.3 يرجى الاشارة إلى مدى موافقتك أو عدم موافقتك على العبارات التالية:

العبارة	لا أوافق بشدة	لا أوافق	محايد	موافق	موافق بشدة
يعي المراجعون بشكل تام مسؤوليتهم تجاه المساهمين					
يعي المراجعون بشكل تام مسؤوليتهم تجاه الطرف الثالث					
يستخدم تقرير المراجع على نطاق واسع من قبل المهتمين					
يعتبر تقرير المراجع مطلب قانونى فقط، ولا يعتمد عليه عند اتخاذ القرارات المالية					

3.3 تقوم عدة أطراف بإستخدام تقرير المراجع الخارجى عند اتخاذ قرارات اقتصادية تتعلق بالقوائم المالية. **إلى أيِّ مدى توافق او لا توافق ان المستخدمين فى الجدول أدناه يعطون التقارير المالية ثقة اكبر إذا كانت معززة بتقرير مراجع خارجى، هذه الثقة ما كانت لتمنح فى حالة عدم وجود تقرير للمراجع.**

المستخدم	لا أوافق بشدة	لا أوافق	محايد	موافق	موافق بشدة
المساهمين					
الإدارة					
الموظفين					
إدارة الضرائب					
الزبائن الحاليين والمتوقعين					
سوق الأوراق المالية					
مصرف ليبيا المركزي					
المصارف المراسلة					
الإعلام					
أعضاء التدريس والمراكز البحثية					
المجتمع بصفة عامة					
أخرى، يرجى التحديد					

الجزء الرابع: معلومات إضافية

1.4 لإضافة أية معلومات عن ممارسة إدارة الأرباح فى المصارف التجارية الليبية، **يرجى استخدام الفراغ التالي:**

يتقدم لكم الباحث بالشكر لاهتمامكم بتعبئة هذا الإستبيان. **للحصول على ملخص بنتائج هذه الدراسة يرجى كتابة البيانات الخاصة بك فى الجدول التالي:**

الإسم	
العنوان	
بريد الكترونى	
الهاتف	
الفاكس	

Appendix 7.3

Questionnaire Responses by only Preparers

Part 1 :General Information (Please respond by ticking (√) in the appropriate box)

Please indicate your age

Less than 25 years old	Between 26 and 30 years old	Between 31 and 40 years old	Between 41 and 50 years old	Over 50 years old
1	3	15	4	4

1.1 Please indicate your gender: M (26) F (1)

2. Are you professionally qualified in accountancy or finance? Yes (8) No (19)

If yes, please indicate which of the following professional qualifications that you have:

Professional Body	
LAAA	6
ICAEW	3
CIMA	
ACCA	
AICPA	
Other, please specify ….	1

3. What is your highest educational qualification?

Qualification	
Doctorate	
Master degree	2
Bachelor	20
Diploma	3
Other, please specify ………	1

4. Please indicate your place of education for your highest degree

Place	
Libya	23
Other Arab country	1
UK	2
USA	1
Other, please specify ………	

5. Please tick your place of work and position

Place of Work		position
A commercial bank	27	
Central Bank of Libya		
The Libyan Stock Market		
Tax Authority		
Audit Firm		
State Audit		
Current or potential investor		
Academia and Research Centres		
Other, please specify ………		

6. Please indicate the work experience, if any, that you have:

Less than 5 years	9	Between 5 and 10 years	8
Between 11 and 15 years	3	Over 15 years	16

Part 2: Financial Reporting Quality and Earnings Management

For the purpose of this questionnaire, financial reporting is defined as being of good quality when it provides useful information to the users of financial statements.

2.1 Please indicate the extent to which you agree or disagree, with the following statements about the quality of financial reporting in Libya.

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Financial reporting, generally, is of good quality	2	6	3	16	
Financial reporting of listed companies is of good quality	2	4	3	18	
Financial reporting of banks generally is of good quality	3	2	5	15	2
Financial reporting of listed banks is of good quality	2	2	7	15	1
Financial reporting by listed banks provides relevant information	2	2	7	14	2
Financial reporting by listed banks provides reliable information	2	4	9	10	1

2.2 Are you familiar with the term "Earnings Management?"

Yes (14) No (12)

2.3 To what extent do you agree or disagree with the following statements about earning management:

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Earnings management means reinvesting the earned profits	2	7	3	10	2
Earnings management means manipulating earnings	2	6	4	11	2
Earnings management is a bank activity which is responsible for planning and controlling reported income		3	7	15	
Earnings management means Increasing or decreasing the reported income according to management's desire	1	4	6	13	1
Other, please specify ………………………					

For the purpose of this questionnaire, "Earnings management" is defined as the manipulation of the externally reported income statement to alter the reported income according to management's desire. [Such adjustments may take place within GAAP but in some cases they could be done in breach of GAAP]. Such manipulation is widely known as 'earnings management' in the professional and academic accounting literature in the US and UK.

2.4 Such earnings management would, according to the literature, affect the quality of financial statements; to what extent do you agree or disagree with the following statements about the Libyan commercial banks:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Earnings management affects the quality of financial statements	1	2	1	19	3
Earnings management is practiced in the private listed banks.	1	3	5	13	4
Earnings management is practiced in the private unlisted banks.		5	8	11	1
Earnings management is practiced in the listed state-owned banks.	1	9	5	9	1
Earnings management is practiced in the unlisted state-owned banks.	1	8	10	6	
Managers are managing earnings to manipulate information communicated to shareholders	4	8	8	6	
Managers are managing earnings for their own benefits	4	8	5	9	
Earnings management enables managers to better communicate economic information to stakeholders	3	11	4	8	
Managers are managing earnings to manipulate information communicated to third party regulators	3	6	6	9	2
Managers are managing earnings to manipulate information communicated to credit rating agencies	2	7	6	9	2

2.5 please indicate to what extent you agree or disagree that bank managers are paying most attention to the following users when it comes to preparing financial statements
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Stakeholder	1	2	3	4	5
Shareholders	1	1	3	14	8
Employees	3	12	4	4	4
Current and potential costumers	2	2	5	16	2
Central Bank of Libya		1	1	15	10
Tax authority		3	4	12	6
The Libyan Stock Market		3	5	14	4
Corresponding banks		1	5	15	4
Bank credit rating agencies		4	6	12	3
Media		7	10	7	2
Academia and research centres	1	7	9	8	1
Society as a whole	1	6	8	7	2
Other, please specify …………………………..					

2.6 Please indicate to what extent you agree or disagree that the following factors motivate Libyan commercial bank managers to manage earnings:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Motivation	**Ownership**	SD	D	NAD	A	SA
Management compensation	State	2	3	2	12	2
	Private	2	1	1	16	3
Job security	State		5	6	7	3
	Private		3	4	12	4
To avoid regulatory interventions	State		6	3	7	4
	Private		4	4	14	1
The desire to report smooth earnings	State		3	9	5	3
	Private		1	5	16	1
To influence other stakeholders	State		5	6	7	1
	Private		4	5	12	2
Because other Libyan banks manage earnings	State		5	9	5	1
	Private		4	8	7	3
To avoid reporting losses	State		5	6	5	4
	Private		5	5	7	5
To meet predetermined expectation (budgets)	State		4	4	10	3
	Private		2	3	15	3
To decrease tax payments	State		5	4	6	5
	Private		5	3	9	5
To influence assessment by credit rating agencies	State		4	6	8	3
	Private		1	5	13	2
To influence stock price	State		4	6	8	3
	Private		2	4	10	5
Other, please specify ……………………..						

Please comment, if you think that listed and unlisted status would influence your response to any of the above factors:

2.7 Please indicate to what extent you agree or disagree that the following areas or techniques may be used by Libyan commercial bank managers to manipulate reported earnings.
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Method	SD	D	NAD	A	SA
Reserves		3	2	20	1
Revenue recognition		2	6	17	
Disposing of high market value assets		6	4	15	1
Investments		6	1	17	2
Concealing losses	2	6	7	10	
Use or misuse of set-aside interests[112]	1	7	7	8	1
Accounting changes	2	7	3	13	
Foreign currency	2	7	3	12	1
Manipulation of the loan loss provision	5	4	5	10	1
Other means, please specify ………………….					

2.8 please indicate to what extent you agree or disagree that the following factors enable Libyan commercial bank managers to manipulate earnings:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Factor	SD	D	NAD	A	SA
Local accounting practice		2	5	15	2
Ineffective external audit function	1	3	4	13	4
Poor corporate governance mechanism	1	1	4	14	5
Poor commercial and business knowledge among users	1	2	5	14	3
Ineffective monitoring by Central Bank of Libya		3	5	14	3
Ineffective monitoring by Libyan Stock Market		1	7	14	3
Ineffective monitoring by Tax authority		3	6	11	4
Difficulty of detection by auditors		7	2	14	1
Difficulty of detection by users		7	3	14	1
Other, please specify …………………..					

2.9 To what extent do you agree or disagree that the following actions would mitigate the practice of earnings management:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Action	SD	D	NAD	A	SA
Adopting international accounting standards (IFRS) in practice				16	9
Applying good corporate governance e.g. existence of audit committee, effective internal auditing…			1	17	7
Educating and training of preparers		1	2	11	11
Educating and training of auditors		3	3	12	7
Educating and training of investors		4	6	10	5
Strengthen audit regulation				18	8
Strengthen oversight of financial reporting				19	7
Other, please specify ……………………………					

[112] Set-aside interests. Literal translation for interests that are calculated and booked as a provision rather than revenue because of a client bad debt risk.

2.10 To what extent, do you agree or disagree with the following statements concerning the ethics of earnings management:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Ethical behaviour means complying with law		3	5	12	4
Ethical behaviour means thinking about the impact of one's decisions on others		2	8	11	3
Earnings management is ethical if practiced within the law		6	8	7	2
Earnings management is ethical if practiced within the GAAP		6	8	9	2
Earnings management affects others' interests		2	4	14	3
Earnings management is an unethical practice	1	3	12	5	2

Part 3: External Auditor

3.1 According to Libyan regulations, only auditors who are listed with the Central Bank of Libya are allowed to audit Libyan commercial banks. This restriction implies that those "listed auditors" are qualified to undertake an effective audit for banks. To what extent do you agree or disagree with the following statements:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Listed auditors, in practice, are well qualified and capable to audit banks	2	5	7	9	4
The auditor's reports are widely relied upon when assessing banks' financial performance.		3	2	18	4
Listed auditors are likely to detect and deter earnings management practices in Libyan commercial banks		4	6	16	1
An auditor's ability to report on earnings management is compromised by audit fess	2	8	7	9	1
An auditor's willingness to report earnings management breaches is compromised by confliction of interest to an auditor's independence	1	7	12	6	1
The external auditor can prevent the practice of EM using the power of the auditor's report		2	5	15	4

3.2 Please indicate the extent by which you agree or disagree with the following statements:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
External auditors are fully aware of their accountability to the shareholders	2		6	14	3
External auditors are fully aware of their accountability to the third parties	1	1	8	13	2
The auditor's report is widely used by interested stakeholders			7	16	2
The auditor's report is only a legal requirement and not used widely in the financial decision making process.	2	13	5	5	

3.3 Presumably, an auditor's report is used by several parties when making economic decisions regarding financial statements. Please indicate to what extent do you agree or disagree that the following stakeholders place greater trust in financial statements of Libyan commercial banks as a result of the auditor's report than they would otherwise do:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Users	SD	D	NAD	A	SA
shareholders		2	2	15	7
Management		2	4	16	4
Employees		3	11	10	1
Tax department		1	4	16	5
Current and potential customers	1	3	3	15	2
The Libyan Stock Market	1	1	2	16	5
Central Bank of Libya		1		19	6
Corresponding banks	2	2	3	14	3
Media	1	4	8	10	1
Academia and research centres		3	8	13	1
Society as a whole		4	8	10	2
Other, please specify ………………					

Part 4: Additional Information

4.1 Please use the space below to make any comments about the earnings management practices in the Libyan Commercial Banks

The researcher would like to take the opportunity to thank you for filling in the questionnaire. Also, if you would like to receive a summary of the research results and findings please write down your name and contact details. Thank you.

Name	
Address	
Email	
Phone number	
Fax number	

Appendix 7.4

Questionnaire Responses by only Auditors

Part 1 :General Information (Please respond by ticking (√) in the appropriate box)

Please indicate your age

Less than 25 years old	Between 26 and 30 years old	Between 31 and 40 years old	Between 41 and 50 years old	Over 50 years old
		5	11	11

1.1 Please indicate your gender: M (25) F (2)

2. Are you professionally qualified in accountancy or finance? Yes (14) No (11)

If yes, please indicate which of the following professional qualifications that you have:

Professional Body	
LAAA	12
ACCA	
AICPA	1
ICAEW	
CIMA	
Other, please specify ….	

3. What is your highest educational qualification?

Qualification	
Doctorate	
Master degree	6
Bachelor	19
Diploma	1
Other, please specify ………	1

4. Please indicate your place of education for your highest degree

Place	
Libya	20
Other Arab country	5
UK	1
USA	1
Other, please specify ………	

5. Please tick your place of work and position

Place of Work		position
A commercial bank		
Central Bank of Libya		
The Libyan Stock Market		
Tax Authority		
Audit Firm	27	
State Audit		
Current or potential investor		
Academia and Research Centres		
Other, please specify ………		

6. Please indicate the work experience, if any, that you have:

Less than 5 years	8	Between 5 and 10 years	2
Between 11 and 15 years	2	Over 15 years	8

Part 2: Financial Reporting Quality and Earnings Management

For the purpose of this questionnaire, financial reporting is defined as being of good quality when it provides useful information to the users of financial statements.

2.1 Please indicate the extent to which you agree or disagree, with the following statements about the quality of financial reporting in Libya.

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Financial reporting, generally, is of good quality	2	8	7	7	1
Financial reporting of listed companies is of good quality	2	5	10	9	1
Financial reporting of banks generally is of good quality	2	3	5	16	1
Financial reporting of listed banks is of good quality	2	3	9	13	
Financial reporting by listed banks provides relevant information	2		10	15	
Financial reporting by listed banks provides reliable information	2	2	14	4	

2.2 Are you familiar with the term "Earnings Management?"

Yes (15) No (7)

2.3 To what extent do you agree or disagree with the following statements about earning management:

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Earnings management means reinvesting the earned profits	1	2	5	16	2
Earnings management means manipulating earnings	3	5	8	7	3
Earnings management is a bank activity which is responsible for planning and controlling reported income	2	3	10	10	
Earnings management means Increasing or decreasing the reported income according to management's desire	1	8	6	9	2
Other, please specify ………………………					

For the purpose of this questionnaire, "Earnings management" is defined as the manipulation of the externally reported income statement to alter the reported income according to management's desire. [Such adjustments may take place within GAAP but in some cases they could be done in breach of GAAP]. Such manipulation is widely known as 'earnings management' in the professional and academic accounting literature in the US and UK.

2.4 Such earnings management would, according to the literature, affect the quality of financial statements; to what extent do you agree or disagree with the following statements about the Libyan commercial banks:

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Earnings management affects the quality of financial statements		1	3	18	5
Earnings management is practiced in the private listed banks.	1	4	12	7	2
Earnings management is practiced in the private unlisted banks.		2	13	10	1
Earnings management is practiced in the listed state-owned banks.	1	5	11	8	
Earnings management is practiced in the unlisted state-owned banks.	1	4	15	3	
Managers are managing earnings to manipulate information communicated to shareholders	1	6	10	6	3
Managers are managing earnings for their own benefits	1	6	9	9	1
Earnings management enables managers to better communicate economic information to stakeholders	3	8	6	8	
Managers are managing earnings to manipulate information communicated to third party regulators	1	9	6	8	1
Managers are managing earnings to manipulate information communicated to credit rating agencies	1	8	9	6	2

2.5 please indicate to what extent you agree or disagree that bank managers are paying most attention to the following users when it comes to preparing financial statements

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Stakeholder	SD	D	NAD	A	SA
Shareholders		1	3	16	7
Employees	1	12	6	6	2
Current and potential costumers		4	6	15	2
Central Bank of Libya		3	3	10	11
Tax authority		1	7	17	1
The Libyan Stock Market		1	8	12	5
Corresponding banks		2	7	13	4
Bank credit rating agencies		3	8	12	4
Media	1	7	11	4	4
Academia and research centres	2	6	11	6	1
Society as a whole	2	8	13	3	1
Other, please specify …………………………..					

2.6 Please indicate to what extent you agree or disagree that the following factors motivate Libyan commercial bank managers to manage earnings:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Motivation	**Ownership**	SD	D	NAD	A	SA
Management compensation	State	1	6	7	11	2
	Private		2	4	14	5
Job security	State		7	7	10	3
	Private		3	4	15	3
To avoid regulatory interventions	State	1	7	3	13	3
	Private	1	6	3	11	4
The desire to report smooth earnings	State		7	8	12	
	Private		5	7	13	
To influence other stakeholders	State	1	8	7	11	
	Private		9	5	9	2
Because other Libyan banks manage earnings	State	1	7	11	7	
	Private	1	7	7	7	1
To avoid reporting losses	State		6	4	13	4
	Private		5	4	11	5
To meet predetermined expectation (budgets)	State		8	7	9	2
	Private		7	6	8	3
To decrease tax payments	State	1	8	8	9	1
	Private		5	4	12	4
To influence assessment by credit rating agencies	State		3	12	12	
	Private		2	9	12	2
To influence stock price	State	1	6	7	11	2
	Private		6	8	9	2
Other, please specify ……………………..						

Please comment, if you think that listed and unlisted status would influence your response to any of the above factors:

2.7 Please indicate to what extent you agree or disagree that the following areas or techniques may be used by Libyan commercial bank managers to manipulate reported earnings.
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Method	SD	D	NAD	A	SA
Reserves		4	3	15	4
Revenue recognition		4	5	16	1
Disposing of high market value assets		6	9	11	1
Investments		3	7	14	3
Concealing losses	1	7	6	12	1
Use or misuse of set-aside interests[113]		2	11	13	1
Accounting changes		4	10	9	2
Foreign currency	1	10	6	9	
Manipulation of the loan loss provision	1	5	6	13	2
Other means, please specify ………………….					

2.8 please indicate to what extent you agree or disagree that the following factors enable Libyan commercial bank managers to manipulate earnings:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Factor	SD	D	NAD	A	SA
Local accounting practice	1	2	8	12	2
Ineffective external audit function		3	3	18	3
Poor corporate governance mechanism			6	18	3
Poor commercial and business knowledge among users			2	22	2
Ineffective monitoring by Central Bank of Libya		1	4	18	4
Ineffective monitoring by Libyan Stock Market		1	8	15	3
Ineffective monitoring by Tax authority		1	6	17	3
Difficulty of detection by auditors		2	10	13	2
Difficulty of detection by users		1	6	18	2
Other, please specify …………………..					

2.9 To what extent do you agree or disagree that the following actions would mitigate the practice of earnings management:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Action	SD	D	NAD	A	SA
Adopting international accounting standards (IFRS) in practice			4	19	4
Applying good corporate governance e.g. existence of audit committee, effective internal auditing…			4	17	6
Educating and training of preparers		1	4	14	7
Educating and training of auditors			1	19	7
Educating and training of investors		2	6	16	3
Strengthen audit regulation			2	15	10
Strengthen oversight of financial reporting			2	17	8
Other, please specify ……………………………					

[113] Set-aside interests. Literal translation for interests that are calculated and booked as a provision rather than revenue because of a client bad debt risk.

2.10 To what extent, do you agree or disagree with the following statements concerning the ethics of earnings management:

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Ethical behaviour means complying with law		3	3	17	3
Ethical behaviour means thinking about the impact of one's decisions on others		2	3	15	6
Earnings management is ethical if practiced within the law	1	7	4	13	1
Earnings management is ethical if practiced within the GAAP	1	6	4	13	2
Earnings management affects others' interests		2	4	18	3
Earnings management is an unethical practice	1	7	11	5	2

Part 3: External Auditor

3.1 According to Libyan regulations, only auditors who are listed with the Central Bank of Libya are allowed to audit Libyan commercial banks. This restriction implies that those "listed auditors" are qualified to undertake an effective audit for banks. To what extent do you agree or disagree with the following statements:

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Listed auditors, in practice, are well qualified and capable to audit banks	1	8	9	5	4
The auditor's reports are widely relied upon when assessing banks' financial performance.	1	4	7	14	1
Listed auditors are likely to detect and deter earnings management practices in Libyan commercial banks	1	5	8	12	1
An auditor's ability to report on earnings management is compromised by audit fess	4	7	10	5	1
An auditor's willingness to report earnings management breaches is compromised by confliction of interest to an auditor's independence	2	5	10	9	1
The external auditor can prevent the practice of EM using the power of the auditor's report	1	5	11	8	1

3.2 Please indicate the extent by which you agree or disagree with the following statements:

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
External auditors are fully aware of their accountability to the shareholders		7	3	12	3
External auditors are fully aware of their accountability to the third parties		5	8	11	1
The auditor's report is widely used by interested stakeholders		5	8	11	1
The auditor's report is only a legal requirement and not used widely in the financial decision making process.		11	1	12	1

3.3 Presumably, an auditor’s report is used by several parties when making economic decisions regarding financial statements. Please indicate to what extent do you agree or disagree that the following stakeholders place greater trust in financial statements of Libyan commercial banks as a result of the auditor’s report than they would otherwise do:

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Users	SD	D	NAD	A	SA
shareholders		3	4	15	3
Management	1	5	3	15	1
Employees	1	5	10	9	
Tax department		3	6	13	2
Current and potential customers		3	7	14	1
The Libyan Stock Market		1	5	15	4
Central Bank of Libya		1	4	15	5
Corresponding banks		3	6	14	2
Media		4	11	9	1
Academia and research centres		3	10	10	2
Society as a whole		4	11	10	
Other, please specify ………………					

Part 4: Additional Information

4.1 Please use the space below to make any comments about the earnings management practices in the Libyan Commercial Banks

The researcher would like to take the opportunity to thank you for filling in the questionnaire. Also, if you would like to receive a summary of the research results and findings please write down your name and contact details. Thank you.

Name	
Address	
Email	
Phone number	
Fax number	

Appendix 7.5

Questionnaire Responses by only Regulators

Part 1 :General Information (Please respond by ticking (√) in the appropriate box)

Please indicate your age

Less than 25 years old	Between 26 and 30 years old	Between 31 and 40 years old	Between 41 and 50 years old	Over 50 years old
	2	8	9	1

1.1 Please indicate your gender: M (20) F ( )

2. Are you professionally qualified in accountancy or finance? Yes (1) No (19)

If yes, please indicate which of the following professional qualifications that you have:

Professional Body	
LAAA	1
ICAEW	
CIMA	
ACCA	
AICPA	
Other, please specify ….	

3. What is your highest educational qualification?

Qualification	
Doctorate	
Master degree	4
Bachelor	14
Diploma	1
Other, please specify ………	1

4. Please indicate your place of education for your highest degree

Place	
Libya	19
Other Arab country	
UK	1
USA	
Other, please specify ………	

5. Please tick your place of work and position

Place of Work		position
A commercial bank		
Central Bank of Libya	20	
The Libyan Stock Market		
Tax Authority		
Audit Firm		
State Audit		
Current or potential investor		
Academia and Research Centres		
Other, please specify ………		

6. Please indicate the work experience, if any, that you have:

Less than 5 years	2	Between 5 and 10 years	7
Between 11 and 15 years	4	Over 15 years	6

Part 2: Financial Reporting Quality and Earnings Management

For the purpose of this questionnaire, financial reporting is defined as being of good quality when it provides useful information to the users of financial statements.

2.1 Please indicate the extent to which you agree or disagree, with the following statements about the quality of financial reporting in Libya.

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Financial reporting, generally, is of good quality		10	5	4	
Financial reporting of listed companies is of good quality		4	12	3	
Financial reporting of banks generally is of good quality		5	7	7	
Financial reporting of listed banks is of good quality		5	7	6	
Financial reporting by listed banks provides relevant information		4	5	10	
Financial reporting by listed banks provides reliable information		5	6	8	

2.2 Are you familiar with the term "Earnings Management?"

Yes (8) No (7)

2.3 To what extent do you agree or disagree with the following statements about earning management:

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Earnings management means reinvesting the earned profits		4	3	8	2
Earnings management means manipulating earnings	3	4	3	6	1
Earnings management is a bank activity which is responsible for planning and controlling reported income	1	4	4	7	1
Earnings management means Increasing or decreasing the reported income according to management's desire		3	6	9	
Other, please specify ………………………					

For the purpose of this questionnaire, "Earnings management" is defined as the manipulation of the externally reported income statement to alter the reported income according to management's desire. [Such adjustments may take place within GAAP but in some cases they could be done in breach of GAAP]. Such manipulation is widely known as 'earnings management' in the professional and academic accounting literature in the US and UK.

2.4 Such earnings management would, according to the literature, affect the quality of financial statements; to what extent do you agree or disagree with the following statements about the Libyan commercial banks:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Earnings management affects the quality of financial statements	1	1		12	4
Earnings management is practiced in the private listed banks.	1	2	3	12	
Earnings management is practiced in the private unlisted banks.		3	6	9	
Earnings management is practiced in the listed state-owned banks.	1	1	6	8	
Earnings management is practiced in the unlisted state-owned banks.		4	7	7	
Managers are managing earnings to manipulate information communicated to shareholders	1	3	7	7	
Managers are managing earnings for their own benefits	1		6	10	1
Earnings management enables managers to better communicate economic information to stakeholders		7	4	6	1
Managers are managing earnings to manipulate information communicated to third party regulators	1	1	7	8	1
Managers are managing earnings to manipulate information communicated to credit rating agencies		4	5	7	2

2.5 please indicate to what extent you agree or disagree that bank managers are paying most attention to the following users when it comes to preparing financial statements
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Stakeholder	SD	D	NAD	A	SA
Shareholders		1	2	15	2
Employees		9	8	2	1
Current and potential costumers		4	8	7	1
Central Bank of Libya		1	2	12	4
Tax authority			5	13	1
The Libyan Stock Market		2	4	13	1
Corresponding banks		2	6	12	
Bank credit rating agencies		3	4	11	2
Media		6	6	8	
Academia and research centres		9	4	6	1
Society as a whole		7	8	3	2
Other, please specify …………………………..					

2.6 Please indicate to what extent you agree or disagree that the following factors motivate Libyan commercial bank managers to manage earnings:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Motivation	**Ownership**	SD	D	NAD	A	SA
Management compensation	State	1	3	4	9	
	Private		4	2	11	1
Job security	State	1	2	2	11	
	Private		4	1	11	1
To avoid regulatory interventions	State	1	4	5	6	
	Private		1	7	9	
The desire to report smooth earnings	State	2		3	11	1
	Private	2		4	12	
To influence other stakeholders	State	2	1	8	5	1
	Private	1		4	12	1
Because other Libyan banks manage earnings	State	1	1	7	6	
	Private	2		7	7	1
To avoid reporting losses	State	2	2	3	8	1
	Private	2	3		11	1
To meet predetermined expectation (budgets)	State	1	1	5	9	
	Private		2	4	11	
To decrease tax payments	State	1	3	3	10	
	Private		1	1	15	
To influence assessment by credit rating agencies	State	1		6	10	1
	Private			5	12	1
To influence stock price	State	1	2	5	7	2
	Private		1	4	11	2
Other, please specify ……………………..						

Please comment, if you think that listed and unlisted status would influence your response to any of the above factors:

2.7 Please indicate to what extent you agree or disagree that the following areas or techniques may be used by Libyan commercial bank managers to manipulate reported earnings.
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Method	SD	D	NAD	A	SA
Reserves	1	1	1	16	
Revenue recognition		2	4	11	1
Disposing of high market value assets	1		6	11	1
Investments			4	14	1
Concealing losses	1	1	6	10	
Use or misuse of set-aside interests[114]	1	1	9	7	
Accounting changes		4	4	10	
Foreign currency		4	7	6	1
Manipulation of the loan loss provision	1	1	1	15	
Other means, please specify ………………….					

2.8 please indicate to what extent you agree or disagree that the following factors enable Libyan commercial bank managers to manipulate earnings:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Factor	SD	D	NAD	A	SA
Local accounting practice			3	16	
Ineffective external audit function			3	12	4
Poor corporate governance mechanism			2	14	3
Poor commercial and business knowledge among users		1	1	16	1
Ineffective monitoring by Central Bank of Libya		2	4	7	5
Ineffective monitoring by Libyan Stock Market		2	5	7	5
Ineffective monitoring by Tax authority		2	3	9	5
Difficulty of detection by auditors		3	4	8	4
Difficulty of detection by users		2	4	10	3
Other, please specify …………………..					

2.9 To what extent do you agree or disagree that the following actions would mitigate the practice of earnings management:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Action	SD	D	NAD	A	SA
Adopting international accounting standards (IFRS) in practice			1	10	8
Applying good corporate governance e.g. existence of audit committee, effective internal auditing…				12	7
Educating and training of preparers				11	8
Educating and training of auditors			3	8	8
Educating and training of investors		1	5	10	3
Strengthen audit regulation				13	6
Strengthen oversight of financial reporting				11	8
Other, please specify ……………………………					

[114] Set-aside interests. Literal translation for interests that are calculated and booked as a provision rather than revenue because of a client bad debt risk.

2.10 To what extent, do you agree or disagree with the following statements concerning the ethics of earnings management:

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Ethical behaviour means complying with law		1	3	13	2
Ethical behaviour means thinking about the impact of one's decisions on others		2	5	11	1
Earnings management is ethical if practiced within the law	1	4	4	8	2
Earnings management is ethical if practiced within the GAAP	1	3	6	9	
Earnings management affects others' interests		2	3	12	2
Earnings management is an unethical practice		6	8	5	

Part 3: External Auditor

3.1 According to Libyan regulations, only auditors who are listed with the Central Bank of Libya are allowed to audit Libyan commercial banks. This restriction implies that those "listed auditors" are qualified to undertake an effective audit for banks. To what extent do you agree or disagree with the following statements:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Listed auditors, in practice, are well qualified and capable to audit banks	1	2	9	8	
The auditor's reports are widely relied upon when assessing banks' financial performance.		2	3	15	
Listed auditors are likely to detect and deter earnings management practices in Libyan commercial banks		2	7	9	2
An auditor's ability to report on earnings management is compromised by audit fess		3	14	3	
An auditor's willingness to report earnings management breaches is compromised by confliction of interest to an auditor's independence		2	16	2	
The external auditor can prevent the practice of EM using the power of the auditor's report		1	6	12	

3.2 Please indicate the extent by which you agree or disagree with the following statements:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
External auditors are fully aware of their accountability to the shareholders		3	2	11	4
External auditors are fully aware of their accountability to the third parties		2	8	7	2
The auditor's report is widely used by interested stakeholders		2	5	11	2
The auditor's report is only a legal requirement and not used widely in the financial decision making process.		11	4	5	

3.3 Presumably, an auditor’s report is used by several parties when making economic decisions regarding financial statements. Please indicate to what extent do you agree or disagree that the following stakeholders place greater trust in financial statements of Libyan commercial banks as a result of the auditor’s report than they would otherwise do:

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Users	SD	D	NAD	A	SA
shareholders		2	1	14	3
Management		1	4	10	5
Employees		1	11	6	2
Tax department		1	6	9	4
Current and potential customers		2	8	7	2
The Libyan Stock Market			2	14	4
Central Bank of Libya		1	3	11	5
Corresponding banks			10	5	5
Media		4	6	7	3
Academia and research centres		2	5	10	3
Society as a whole		4	6	8	2
Other, please specify ………………					

Part 4: Additional Information

4.1 Please use the space below to make any comments about the earnings management practices in the Libyan Commercial Banks

The researcher would like to take the opportunity to thank you for filling in the questionnaire. Also, if you would like to receive a summary of the research results and findings please write down your name and contact details. Thank you.

Name	
Address	
Email	
Phone number	
Fax number	

Appendix 7.6

Questionnaire Responses by only Users

Part 1 :General Information (Please respond by ticking (√) in the appropriate box)

Please indicate your age

Less than 25 years old	Between 26 and 30 years old	Between 31 and 40 years old	Between 41 and 50 years old	Over 50 years old
	11	10	7	

1.1 Please indicate your gender: M (19) F (9)

2. Are you professionally qualified in accountancy or finance? Yes (5) No (23)

If yes, please indicate which of the following professional qualifications that you have:

Professional Body	
LAAA	5
ICAEW	
CIMA	
ACCA	
AICPA	
Other, please specify ….	

3. What is your highest educational qualification?

Qualification	
Diploma	3
Bachelor degree	7
Master degree	15
Doctorate	3
Other, please specify ………	

4. Please indicate your place of education for your highest degree

Place	
Libya	25
Other Arab country	2
UK	1
USA	
Other, please specify ………	

5. Please tick your place of work and position

Place of Work		position
A commercial bank		
Central Bank of Libya		
The Libyan Stock Market		
Tax Authority		
Audit Firm		
State Audit		
Current or potential investor		
Academia and Research Centres	15	
Other, please specify ………	13	

6. Please indicate the work experience, if any, that you have:

Less than 5 years	8	Between 5 and 10 years	1
Between 11 and 15 years	5	Over 15 years	1

7. Where applicable, please describe any work experience that you have had in the Libyan banking sector (e.g. accountant for 5 years, internal auditor for 3 years)

Part 2: Financial Reporting Quality and Earnings Management

For the purpose of this questionnaire, financial reporting is defined as being of good quality when it provides useful information to the users of financial statements.

2.1 Please indicate the extent to which you agree or disagree, with the following statements about the quality of financial reporting in Libya.

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Financial reporting, generally, is of good quality	7	13	3	5	
Financial reporting of listed companies is of good quality	5	6	9	8	
Financial reporting of banks generally is of good quality	2	8	10	8	
Financial reporting of listed banks is of good quality	2	6	8	9	3
Financial reporting by listed banks provides relevant information	1	8	7	11	1
Financial reporting by listed banks provides reliable information	1	5	14	8	

2.2 Are you familiar with the term "Earnings Management?"

Yes (20) No (3)

2.3 To what extent do you agree or disagree with the following statements about earning management:

(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Earnings management means reinvesting the earned profits	5	5	6	9	
Earnings management means manipulating earnings	3	4	1	12	5
Earnings management is a bank activity which is responsible for planning and controlling reported income	5	3	5	9	2
Earnings management means Increasing or decreasing the reported income according to management's desire	1	1	7	10	7
Other, please specify ………………………					

For the purpose of this questionnaire, "Earnings management" is defined as the manipulation of the externally reported income statement to alter the reported income according to management's desire. [Such adjustments may take place within GAAP but in some cases they could be done in breach of GAAP]. Such manipulation is widely known as 'earnings management' in the professional and academic accounting literature in the US and UK.

2.4 Such earnings management would, according to the literature, affect the quality of financial statements; to what extent do you agree or disagree with the following statements about the Libyan commercial banks:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Earnings management affects the quality of financial statements		1		23	4
Earnings management is practiced in the private listed banks.		5	15	6	2
Earnings management is practiced in the private unlisted banks.		4	15	8	1
Earnings management is practiced in the listed state-owned banks.		5	14	9	
Earnings management is practiced in the unlisted state-owned banks.		5	13	8	1
Managers are managing earnings to manipulate information communicated to shareholders	1	7	5	11	2
Managers are managing earnings for their own benefits		6	9	10	3
Earnings management enables managers to better communicate economic information to stakeholders	3	13	5	6	1
Managers are managing earnings to manipulate information communicated to the regulators		5	7	13	3
Managers are managing earnings to manipulate information communicated to credit rating agencies		6	9	9	3

2.5 please indicate to what extent you agree or disagree that bank managers are paying most attention to the following users when it comes to preparing financial statements
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Stakeholder	SD	D	NAD	A	SA
Shareholders		4	2	18	4
Employees		10	4	12	2
Current and potential costumers		5	5	15	2
Central Bank of Libya			3	14	11
Tax authority		4	2	13	9
The Libyan Stock Market		2	6	15	5
Corresponding banks		5	9	12	2
Bank credit rating agencies		5	10	10	3
Media	4	10	6	7	1
Academia and research centres	4	12	5	7	
Society as a whole	3	13	5	7	
Other, please specify …………………………..					

2.6 Please indicate to what extent you agree or disagree that the following factors motivate Libyan commercial bank managers to manage earnings:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Motivation	**Ownership**	SD	D	NAD	A	SA
Management compensation	State	1	5	4	11	5
	Private		3	7	10	6
Job security	State	1	4	4	12	4
	Private	1	4	7	11	4
To avoid regulatory interventions	State	1	3	4	16	4
	Private	1	2	8	11	4
The desire to report smooth earnings	State	2	2	7	13	4
	Private	2	1	7	11	4
To influence other stakeholders	State	2	6	7	8	5
	Private	2	4	6	7	6
Because other Libyan banks manage earnings	State	1	4	10	11	2
	Private	1	3	9	10	2
To avoid reporting losses	State	1		4	17	6
	Private	1	1	5	14	3
To meet predetermined expectation (budgets)	State	2	3	8	9	5
	Private	2	3	7	10	2
To decrease tax payments	State	1	5	7	13	2
	Private	1	1	6	12	6
To influence assessment by credit rating agencies	State		4	11	11	2
	Private		2	9	9	5
To influence stock price	State		5	6	12	5
	Private		4	4	10	7
Other, please specify ……………………..						

Please comment, if you think that listed and unlisted status would influence your response to any of the above factors:

2.7 Please indicate to what extent you agree or disagree that the following areas or techniques may be used by Libyan commercial bank managers to manipulate reported earnings.
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Method	SD	D	NAD	A	SA
Reserves		2	8	15	3
Revenue recognition		3	6	16	3
Disposing of high market value assets		5	7	12	4
Investments		3	5	17	3
Concealing losses		5	4	13	6
Use or misuse of set-aside interests[115]		5	11	8	4
Accounting changes		5	5	15	3
Foreign currency		2	11	13	2
Manipulation of the loan loss provision	2	4	7	10	5
Other means, please specify ………………….					

2.8 please indicate to what extent you agree or disagree that the following factors enable Libyan commercial bank managers to manipulate earnings:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Factor	SD	D	NAD	A	SA
Local accounting practice	1	8	5	9	5
Ineffective external audit function		5	1	14	8
Poor corporate governance mechanism		3	7	8	10
Poor commercial and business knowledge among users		5	3	9	10
Ineffective monitoring by Central Bank of Libya		3	6	10	9
Ineffective monitoring by Libyan Stock Market		4	5	9	10
Ineffective monitoring by Tax authority		5	6	10	7
Difficulty of detection by auditors	1	7	3	9	8
Difficulty of detection by users		4	7	8	9
Other, please specify …………………..					

2.9 To what extent do you agree or disagree that the following actions would mitigate the practice of earnings management:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Action	SD	D	NAD	A	SA
Adopting international accounting standards (IFRS) in practice			2	13	13
Applying good corporate governance e.g. existence of audit committee, effective internal auditing…			3	9	16
Educating and training of preparers		1	1	10	16
Educating and training of auditors			1	10	17
Educating and training of investors		1	4	9	14
Strengthen audit regulation			1	7	20
Strengthen oversight of financial reporting			2	9	17
Other, please specify ……………………………					

[115] Set-aside interests. Literal translation for interests that are calculated and booked as a provision rather than revenue because of a client bad debt risk.

2.10 To what extent, do you agree or disagree with the following statements concerning the ethics of earnings management:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Ethical behaviour means complying with law	1	6	2	14	5
Ethical behaviour means thinking about the impact of one's decisions on others			6	16	5
Earnings management is ethical if practiced within the law		6	8	10	4
Earnings management is ethical if practiced within the GAAP	1	8	4	11	4
Earnings management affects others' interests		2	3	20	3
Earnings management is an unethical practice	1	7	10	5	4

Part 3: External Auditor

3.1 According to Libyan regulations, only auditors who are listed with the Central Bank of Libya are allowed to audit Libyan commercial banks. This restriction implies that those "listed auditors" are qualified to undertake an effective audit for banks. To what extent do you agree or disagree with the following statements:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
Listed auditors, in practice, are well qualified and capable to audit banks	2	7	7	10	2
The auditor's report is relied upon when assessing a bank's financial performance		3	3	17	5
Listed auditors are likely to detect and deter earnings management practices in Libyan commercial banks	1	8	7	8	4
An auditor's ability to report on earnings management is compromised by audit fess	1	6	8	11	2
An auditor's willingness to report earnings management breaches is compromised by confliction of interest to an auditor's independence	1	6	8	10	3
The external auditor can prevent the practice of EM using the power of the auditor's report		4	6	15	3

3.2 Please indicate the extent by which you agree or disagree with the following statements:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Statement	SD	D	NAD	A	SA
External auditors are fully aware of their accountability to the shareholders		12	5	8	3
External auditors are fully aware of their accountability to the third parties		10	9	7	2
The auditor's report is widely used by interested stakeholders		10	6	10	2
The auditor's report is only a legal requirement and not used widely in the financial decision making process	3	10	2	10	3

3.3 Presumably, an auditor's report is used by several parties when making economic decisions regarding financial statements. Please indicate to what extent do you agree or disagree that the following stakeholders place greater trust in financial statements of Libyan commercial banks as a result of the auditor's report than they would otherwise do:
(Note: SD = strongly disagree, D= disagree, NAD= neither agree nor disagree, A= agree and, SA= strongly agree)

Users	SD	D	NAD	A	SA
shareholders	1	2	2	18	5
Management		7	3	11	7
Employees	1	11	4	9	3
Tax department		7	3	10	8
Current and potential customers	2	5	6	10	5
The Libyan Stock Market		2	2	13	11
Central Bank of Libya		2	3	10	13
Corresponding banks		5	7	8	7
Media	3	5	10	5	5
Academia and research centres	2	7	8	6	5
Society as a whole	4	5	10	6	3
Other, please specify ………………					

Part 4: Additional Information

4.1 Please use the space below to make any comments about the earnings management practices in the Libyan Commercial Banks

The researcher would like to take the opportunity to thank you for filling in the questionnaire. Also, if you would like to receive a summary of the research results and findings please write down your name and contact details. Thank you.

Name	
Address	
Email	
Phone number	
Fax number	